TO SHARE AND SHARE ALIKE: AN EXAMINATION OF THE TREATMENT OF COMMUNITY PROPERTY IN FLORIDA AND THE NEW FLORIDA COMMUNITY PROPERTY TRUST ACT

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A vastly increasing amount of married couples are moving to the State of Florida to take up residency.[1] Due to the high growth in the number of people moving to Florida, the state's population surpassed 20 million in 2015, and the state is adding over 1,000 people per day.[2] And those statistics are from the pre-COVID population boom in Florida! In today's ever-increasing mobile society, many of these couples may have come to Florida from a community property jurisdiction or may have acquired property in a community property jurisdiction at some point during their marriage.

With the increased emphasis on income tax planning caused by the higher estate and gift tax exemptions, as well as portability, many practitioners are revisiting the issue of "stepped-up" basis, which has favored joint owners who live in community property states. Passage of the Patient Protection and Affordable Care Act of 2010, the American Tax Payer Relief Act of 2012, and the Tax Cuts and Jobs Act of 2017 have made income tax planning, specifically with respect to capital gains, an issue to be brought to the forefront of any estate planning strategy, regardless of net worth. It has therefore become even more important for attorneys in Florida to be able to identify and determine the community property status of Florida couples' assets, and to examine the treatment of community property for Florida residents under Florida law.

Florida has also now taken the monumental step of enacting legislation which will permit the creation of community property trusts in our state. This is a very significant development in the treatment of community property under Florida law. Every trusts and estates practitioner in Florida should be familiar with the provisions of the Florida Community Property Trust Act, what type of clients would benefit from the implementation and usage of Florida Community Property Trusts, and the situations in which Florida Community Property Trusts should be recommended and considered. If you want to dive right into the Florida Community Property Trust Act, the discussion of the Act is contained in Section VI of this outline. But first off, the outline contains

[1] Florida remains the largest recipient of state-to-state migration in the United States (https://www.census.gov/library/stories/2019/04/moves-from-south-west-dominate-recent-migration-flows.html), and is the top choice among retirees (https://smartasset.com/retirement/where-are-retirees-moving-2018-edition).

[2] Per the 2020 United States Census, Florida was one of the fastest growing states in the country. The state's population increased by 14.56% since the 2010 United States Census. Starting in 2021, Florida is now the fastest growing state in the country (for the first time since 1957), with its population increasing by 1.9% between 2021 and 2022.

a detailed discussion of community property and its current treatment under Florida law, as it is important to have a working knowledge of those subjects if you want to become a Florida Community Property Trust expert!

I. COMMUNITY PROPERTY IN THE UNITED STATES

A. Brief Synopsis of Community Property. The community property system derives from civil law (Spanish or French law), whereas common law property systems derive from English law, under which title is critical in determining ownership of property. Community property law governs each spouse's interest in property acquired during the marriage. If assets are treated as community property, each spouse owns an undivided ½ interest in the assets. Each spouse has the power to direct the disposition at death of that spouse's ½ interest. Also, the deceased spouse's interest in community property does not pass automatically to the surviving spouse by right of survivorship in the majority of cases. Under community property rules, generally all assets acquired by a married couple during a marriage belong to both spouses as equal undivided interests (similar to a partnership). These rights are vested in each spouse at the time the assets are acquired. The vesting occurs even if title is held in the name of only one of the spouses. This is contrasted with common law states, where the rights to property acquired in the name of one spouse during a marriage may ultimately be divided between the spouses, but such property right for the spouse who is not the record owner does not become vested until the right is determined by a court in a divorce action, or at death through inheritance or the institution of an election share action.

B. Community Property Jurisdictions. Arizona[3], California[4], Idaho[5], Louisiana[6], Nevada[7], New Mexico[8], Texas[9] and Washington[10] all follow community property systems in characterizing property acquired during the marriage. Wisconsin[11] adopted the Uniform Marital Property Act in 1986, and is also considered a community property state (although community property is referred to as "marital property" in Wisconsin).[12] Alaska adopted a version of the

[3] Ariz. Rev. Stat. §§ 25-211 to §§ 25-218.

[4] Cal. Fam. Code §§ 750 to 755.

[5] Idaho Code §§ 32-901 to 32-929.

[6] La. Rev. Codes, tit. 9 §§ 2801 to 2802; La. Civ. Code, arts. 2334 to 2369.8.

[7] Nev. Rev. Stat. §§ 123.010 to 123.310.

[8] N.M. Stat. §§ 40-3-1 to 40-3-17.

[9] Tx. Fam. Code §§ 3.001 to 3.410.

[10] Wash. Rev. Codes §§ 26.16.010 to 26.16.250.

[11] Wis. Stat. §§ 766.01 to 766.97.

[12] The IRS recognized the validity of Wisconsin's community property regime in Rev. Rul. 87-13.

Uniform Marital Property Act in 1998. While Wisconsin's community property system is mandatory unless a couple elects out, the Alaska version of the Uniform Marital Property Act[13] provides the opposite, in that Alaska residents must affirmatively opt-in to assets being treated as community property. A comparison of the laws of the nine "true" community property states, as well as Wisconsin, can be found in IRS Manual 25.18.1 (entitled "Basic Principles of Community Property").

It is important to note that a majority of the countries around the world have long had community property laws in place, including two U.S. possessions (Puerto Rico - one of every three migrants to the US mainland from Puerto Rico settles in Florida - and Guam). Almost all of the countries of Latin and South America, Europe (England, Wales, Ireland and North Ireland being the only exceptions), Asia (including China), and Africa are community property jurisdictions.[14] Many citizens of these countries have relocated to the United States and will continue to do so, bringing community property (or the proceeds from community property) with them. Therefore, the same principles and issues discussed herein apply to these foreign persons as well, once they become residents of Florida.

C. Community Property Trust States. All of the aforementioned community property states recognize the use of community property trusts to retain the community property character of assets. Alaska was the first state to enact legislation permitting residents of common law states to establish community property trusts in its state (in order to convert property owned in a common law jurisdiction into community property). Tennessee (in 2010)[15], South Dakota (in 2016)[16], Kentucky (in 2020)[17], and now Florida (in 2021)[18] have followed suit and enacted community property trust acts, allowing both residents and non-residents to contribute property to a community property trust established in those states. There have been no court decisions or IRS rulings or pronouncements as to whether elective community property under the Alaska, Tennessee or South Dakota statutes will qualify as community property for federal tax purposes. Community property trusts are discussed in more detail in Section V of this outline, and the Florida Community Property Trust Act is discussed in Section VI of this outline.

D. Common Property States v. Common Law States. A community property regime is generally similar to a 50/50 equal partnership where each spouse is considered to hold an undivided interest in the whole of the property. In a common law state (sometimes referred to as a separate property regime), the legal title of an asset is likely to be determinative of its

[13] Alaska Stat. §§ 34.77.010 to 34.77.995. The Alaska Community Property Act, which was enacted in 1998, was amended in 2000, 2001 and 2013 to provide more flexibility and safeguards.

[14] The countries which are common law jurisdictions typically have a strong history or connection with Britain. Examples include Australia, Canada, India, and Ireland. Israel is also considered a common law jurisdiction.

[15] Tenn. Code §§ 35-17-101 to 35-17-108.

[16] S.D. Codified L. §§ 55-17-1 to 55-17-14.

[17] KRS 386.620 to 386.624.

[18] Fla. Stat. § 736.1501 *et seq*.

ownership, and property titled in one spouse's name is presumptively that spouse's own property. In community property states, there generally exists a presumption that any property owned by either or both spouses during or after the marriage is community property. This presumption usually places the burden of proof on the party asserting that a particular asset is separate property to show why it is separate property. The opposite is true in most common law states.

E. Differences Among State Community Property Laws. While the general requirements for spouses to acquire community property, primarily that the couple is married,[19] are similar among all of the community property states, there are significant differences in each state's community property laws. Individual states vary on such issues as whether income from separate property is community property or separate property, whether life insurance is community property or separate (depending on the source of payment of premiums), and to what extent community property is subject to the debts of one of the spouses. Again, the comparison chart contained in IRS Manual 25.18.1 is a good starting point when comparing the specifics of the various state community property laws.

F. Classification of Property. In community property jurisdictions, some consequences of characterizing assets as community property or separate property involve considerations of the management and control of the property, gratuitous transfers of property, and creditors' rights. It is important to know the distinctions between the following classes of property for these purposes[20]:

1. Community Property. As discussed above, community property is generally defined as all property acquired by either member of the married couple while residing in a community property jurisdiction during the marriage, except property acquired by gift, devise or descent. Compensation earned by either spouse during the marriage, as well as increases in the value of community property assets, and income generated by community property assets are all community property. Proceeds from the sale of community property remains classified as community property. There is a rebuttable presumption that all property acquired during the marriage is community property.[21] The fact that title to an asset acquired during the marriage is in only one spouse's name generally does not rebut this presumption. Additionally, the fact that property was acquired during the marriage through the effort, skill or industry of just one of the spouses generally does not affect its characterization as community property. If separate property (discussed below) and community property have been commingled to such a degree that the

[19] The majority of states require a couple to be legally married in order to own assets as community property. California, Nevada and Washington specifically provide that their community property laws apply to registered domestic partners. However, registered domestic partners will not receive the same treatment from a tax perspective as a married couple because only valid marriages are recognized for federal tax purposes. Same-sex marriages will be recognized for purposes of community property treatment in all states in the U.S. as a result of the United States Supreme Court's holding in *Obergefell v. Hodges*.

[20] While general definitions are set forth herein, a practitioner should review the specific laws of the state where the community property or separate property originated to identify any state-specific issues relating to the classification of property.

[21] See *Arizona Central Credit Union v. Holden*, 432 P.2d 276 (Ariz. Ct.App. 1967); *Stahl v. Stahl*, 430 P.2d 685 (Idaho 1967); *Johnson v. Johnson*, 584 S.W.2d 307 (Tex. Civ.App. 1979).

remaining property cannot be segregated as to its sources (i.e., it is untraceable), the entire asset is presumed to be community property.[22]

2. Separate Property. Separate property is generally defined as property acquired by either spouse prior to the marriage, as well as property received by either spouse, individually, during the marriage by gift, devise or bequest from a third party. In Arizona, California, Nevada, New Mexico and Washington, income from separate property assets retains its separate property character. Idaho, Texas and Louisiana treat income from separate property as community property. The spouses can also opt out of community property treatment of some or all of their assets through an agreement between the spouses. This will generally be sufficient to transmute community property to separate property in most states.

3. Jointly-Held Property. Generally, real property titled in both spouses' names is considered community property in most community property jurisdictions. A conveyance to the spouses as joint tenants with rights of survivorship will generally overcome the presumption that the property is community property only if there is a clear statement of intent in the deed or other evidence of title, or if there is a separate written agreement.[23] Some community property states characterize property titled as joint tenants with rights of survivorship as community property, but also honor the survivorship rights of the surviving spouse in the property created by agreement between the spouses. The same is not true with tenancy by the entireties property (in those states, such as Florida, that recognize this type of ownership). Some practitioners strongly believe that community property ownership and tenancy by the entireties ownership cannot coexist due to the fact that the five unities of title required for tenancy by the entireties (time, title, interest, possession, and marriage) are not all present with community property.

4. Quasi-Community Property. Most of the community property states have created a class of property known as "quasi-community property." Quasi-community property is personal property acquired while the couple resided in a common law jurisdiction, such as Florida, which has been brought into the community property state and would have been community property if it had been acquired by the couple while domiciled in that state. In California, Idaho and New Mexico, this type of property is treated as community property for purposes of both the dissolution of a marriage and disposition at death. Washington only applies the characterization for disposition at death purposes. Texas and Arizona only apply it in the divorce setting.

G. Unique Characteristics of Community Property.

1. Federal Tax Treatment. Community property is treated differently than separate property under the Internal Revenue Code. Some of these differences are discussed in Section II of this outline.

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[22] See *Flowers v. Flowers*, 578 P.2d 1006 (Ariz. Ct.App. 1978); *In re Witte's Estate*, 150 P.2d 595 (Wash. 1944); *Stahl* (cited *supra*).

[23] See *Collier v. Collier*, 242 P.2d 527 (Ariz. 1962*); In re Estate of Cooke*, 524 P.2d 176 (Idaho 1974).

2. Lifetime Gifts. Either spouse may make gifts of that spouse's separate property without the other spouse's joinder or consent. However, a gift of community property made by one spouse without spousal consent will be subject to the claims of the non-donor spouse. Most importantly, if community property is gifted, both spouses are deemed to be the donor of ½ of that property if there has been consent for the gift. As a result, if the gift to a donee during the calendar year does not exceed twice the amount of the annual gift tax exclusion under IRC 2513 (currently $30,000), then there is no need to file a gift tax return to "split" the gift.[24]

3. Disposition at Death. A decedent's ability to dispose of community property is completely different than if the decedent owned separate/common law property. The devise of a decedent's separate or common law property is determined by how title to the property is owned. With community property, the community property law statute sets forth how the community property is to be devised at a decedent's death. In almost all cases, the decedent may devise ½ of the community property, with the remaining interest in the community property being deemed to be owned by the surviving spouse and not subject to devise or distribution by the decedent.

4. Creditor Claims. Generally, community property assets can be reached to satisfy debts incurred by either spouse during the marriage. This is a potential downside to the classification of an asset as community property. Separate property of each spouse generally is not liable for the individual debts of the other spouse.

II. FEDERAL TAX ISSUES

Community property offers some tax benefits not available in a common law marital property state like Florida. An additional tax burden on widows and widowers in common law states is caused by a unique provision of the Internal Revenue Code which recognizes a 50% step-up in basis at death of one joint tenant in a non-community property state[25] (since the surviving spouse is only considered to have received ½ of the property from the decedent). However, if the property is considered "community property held by the decedent and the surviving spouse under the community property laws of any State," then the federal tax law considers the surviving spouse's share to have come from the decedent, resulting in a 100% step-up in the basis of the property for capital gains purposes.[26] Community property treatment for basis purposes can also reduce a surviving spouse's future income tax burden relating to depreciated property, such as

[24] While eliminating the need to "split" gifted community property on a federal gift tax return can be beneficial, it can also create a trap for the unwary. For example, if husband is making annual gifts to a Spousal Lifetime Access Trust of which wife is a beneficiary, care should be taken to ensure that only separate property is gifted to the trust, in order to avoid wife being treated as a donor of ½ of the property and resulting in estate tax inclusion issues.

[25] There is an exception to this rule in the case of joint property purchases prior to 1977, but it does not come up often. See *Gallenstein v. United States*, 975 F. 2d 286 (6th Cir. 1992).

[26] Under IRC § 1411, the capital gains tax rate is currently 20% in most cases. In addition, the 3.8% "Obamacare" tax will be applied under § 1411 for most high net worth clients. This net investment tax applies to capital gains income for those with certain levels of modified adjusted gross income.

rental real estate (a 25% tax rate applies to recaptured depreciation), and the 3.8% net income investment tax (i.e., the Obamacare tax) after the death of the spouse first to die because of the full step-up in basis.

A. Community Property at Death. For decedents dying after December 31, 1947, the surviving spouse's ½ share of community property held by the decedent and the surviving spouse under the community property laws of any state, U.S. possession, or foreign country is considered to have been acquired from or to have passed from the decedent for purposes of the basis rules of IRC § 1014, even though that property is not included in the decedent's gross estate for federal estate tax purposes. This rule applies if at least ½ of the whole of the community property interest is includable in the decedent's gross estate.[27]

1. IRC § 1014(b)(6). This provision of the Internal Revenue Code provides that, for purposes of IRC § 1014(a), property acquired or passing from the decedent includes "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."

2. Original Policy Behind IRC § 1014(b)(6). When this provision of the Internal Revenue Code was originally enacted in the 1940s, most marital property was earned by the husband. Therefore, in a common law jurisdiction, nearly all of a couple's property may have legally been the separate property of the husband and received a full step-up in basis at his death. In a community property state, however, the husband's earnings were community property, resulting in the husband only being able to bequeath half the property (and thus limiting the step-up in basis to that half of the property). This resulted in an inequality between common law and community property jurisdictions.

In *Willging v. United States*[28], the Ninth Circuit stated that "Section 1014(b)(6) was designed to equalize the incidence of taxation between community-property and common-law states." The court goes on to add that § 1014(b)(6) was not designed "to provide a special benefit to community-property taxpayers." Ironically, § 1014(b)(6) today clearly provides a tax advantage to those in community property states because property is no longer as concentrated in a husband's hands as when the section was originally enacted, thus swinging the benefit of the step-up in basis to taxpayers with community property.

B. Valuation Discount. Community property is not subject to IRC § 2040, which states that the value of certain jointly owned property is strictly the decedent's percentage interest

[27] IRC § 1014(b)(6); Reg. § 1.1014-2(a)(5); see also Rev. Rul. 55-605, Rev. Rul. 59-220, Rev. Rul. 66-283, and Rev. Rul. 87-98.

[28] 474 F.2d 14 (9th Cir. 1973).

without a discount.[29] If the decedent's ½ interest is community property, a fractional interest discount can be applied (especially if the community property is real property or a closely held business interest).

C. Spouses as LLC Members. A couple operating under a community property law can form a LLC as a disregarded entity with both spouses being members of the LLC. Under a common law marital property regime like Florida, generally if both spouses are members of one LLC, the entity is treated for tax purposes as a partnership and not as a disregarded entity[30] (although the same result could possibly be achieved in Florida by having the couple own the membership interest as tenants by the entireties).

D. Gift Splitting. As previously discussed, a couple operating under community property law can make a gift and receive automatic gift splitting without having to file a gift tax return. The instructions for IRS Form 709 state "[y]ou must file a gift tax return to split gifts with your spouse," but notes that "[i]f a gift is of community property, it is considered made one-half by each spouse." However, some community property states (such as California) prohibit such a gift without the written consent of the other spouse.

III. TREATMENT OF COMMUNITY PROPERTY IN FLORIDA

Florida, like many other common-law jurisdictions, recognizes that a change of domicile from a community property state to a common law state should not affect the community property character of the property previously acquired.[31] As discussed below, Florida law clearly anticipates the potential that couples moving to Florida are entitled to retain any community property rights they bring with them to Florida. For clients who move to Florida owning community property, there are some potentially significant tax advantages that should not be ignored, and significant tax liabilities which could result from unintentionally destroying the community property nature of assets. Community property acquired in a community property jurisdiction should remain community property after it is transported to Florida, unless steps are taken to convert it to separate property or it is (intentionally or unintentionally) commingled with separate property.

A. The *Quintana* Decision. In *Quintana v. Ordono*, 195 So.2d 577 (Fla. 3d DCA 1967), *aff'd* 202 So.2d 178, the Third District Court of Appeal analyzed the application of community property rules in the State of Florida. The court characterized assets purchased in Florida with the proceeds from assets a couple acquired while domiciled in a community property jurisdiction (in this case, Cuba) as community property. In *Quintana*, the decedent held title to personal property acquired during his marriage while he was working in Florida but was domiciled in Cuba. The decedent had willed the property to his children and his wife sued for a portion. The court examined the law of Cuba, determined that neither spouse had any separate property that he

[29] See *Propstra v. U.S.*, 680 F.2d 1248 (9th Cir. 1982).

[30] See Rev. Rul. 2002-69.

[31] See, e.g., *Restatement (Second) of Conflict of Laws* § 222 (1971).

or she brought into their marriage, and concluded that the subject property was community property so that one-half of it was the wife's property. The couple's change of domicile from Cuba to Florida after the property had been acquired did not affect this conclusion. The *Quintana* case has become settled authority for the analysis that ought to be undertaken when examining the effects in Florida of community property rules.[32] Courts in other states have cited to *Quintana* for the proposition that community property retains its character when a married couple moves to a common law jurisdiction.

B. Florida Uniform Disposition of Community Property Rights at Death Act.

1. Background. The holding in *Quintana* was essentially codified when Florida adopted a version of the Uniform Disposition of Community Property Rights at Death Act ("UDCPRDA") in 1992. The UDCPRDA generally provides that property which is considered community property in a community property jurisdiction, when brought into a state which has adopted a version of the UDCPRDA will be treated like community property at the death of the first spouse to die.

The Uniform Law Commission adopted the following statement of purpose for the UDCPRA:

> "Spouses who have been domiciled in a community property jurisdiction frequently move to a jurisdiction which has no such system of marital rights. The Uniform Disposition of Community Property Rights at Death Act (1971) provides a system for the disposition of estates consisting of *both* separate property of spouses *and* property which was community property (or derived from community property) in which both spouses have an interest.
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> The Uniform Act has a very limited scope, and is intended to be enacted by non-community property states. The Act defines the dispositive rights, at death, of a married person as to his or her interests at death in property "subject to the Act" and is limited to real property, located in the enacting state, and personal property of a person domiciled in the enacting state.
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> The purpose of the Act is to preserve the rights of each spouse in property which was community property prior to change of domicile, as well as in property substituted therefore where the spouses have not indicated an intention to sever or alter their "community" rights."

[32] The *Quintana* case was favorably cited in *Camara v. de la Camara*, 330 So. 2d Fla. 818 (Fla. 3d DCA 1976), and in a case to determine the extent to which the law of Puerto Rico, where the parties lived when they entered into a prenuptial agreement, should govern in a probate proceeding in Florida, where the parties were residing at the husband's death, *Estate of Santos v. Nicole-Sauri*, 648 So. 2d 277 (Fla. 4th DCA 1995).

The UDCPRDA has been adopted in 16 states: Alaska, Arkansas, Colorado, Connecticut, Florida, Hawaii, Kentucky, Michigan, Minnesota, Montana, New York, North Carolina, Oregon, Utah, Virginia and Wyoming.

2. Summary of the Florida Uniform Act. Florida's version of the UDCPRDA was incorporated into the Florida Probate Code in Chapter 732.[33]

(a) Fla. Stat. § 732.216. Short title. Sections 732.216 through 732.228 of the Florida Probate Code may be cited as the "Florida Uniform Disposition of Community Property Rights at Death Act" (referred to herein as the "Florida Uniform Act").

(b) Fla. Stat. § 732.217. Application. Section 732.217 defines property subject to the Florida Uniform Act. It applies to all real and personal property which is traceable from a married person's property which was owned in a community property jurisdiction.

(i) Personal Property. The Act applies to personal property (regardless of location) which (1) was acquired, or became and remained, community property, (2) was acquired with the rents, issues, or income of, or the proceeds from, or in exchange for, community property, or (3) is traceable to community property. This subsection is designed to cover all personal property which was acquired while the spouses were domiciled in a community property state, to the extent that it would have been treated as community property by that state at the time of acquisition and that no further action terminated the community character of the property. It also includes any property which was not originally community property but became such by agreement and, further, brings within the Act any personal property which can be traced back to a community property source.

Example from the UDCPRDA. H and W, while domiciled in California, purchased 100 shares each of A Co., B Co., and C Co. stock with community property (earnings of H). H and W moved to Michigan, which had enacted the Act, and while domiciled there H sold the 100 shares of A stock and with the proceeds purchased 100 shares of D stock. Subsequently H and W became domiciled in Florida; H sold the B stock and 50 shares of D Co. stock and purchased 150 shares of E stock. H died domiciled in Florida with 100 shares of C Co., 50 shares of D Co. and 150 shares of E Co. stock; all of the stock had always been registered in H's name. All of the shares, traceable to community property or the proceeds therefrom, constitute property subject to the Florida Uniform Act.

(ii) Real Property. The Act also applies to real property located in Florida which (1) was acquired with the rents, issues, or income of, the proceeds from, or in exchange for, property acquired as, or which became and remained, community property, or (2) is traceable to community property. An important exception is that the Act specifically provides that it does not apply to real property titled as tenants by the entireties. This exception is unique to Florida and is not contained in the Uniform Disposition of Community Property Rights at Death Act nor in the legislation of any other states which passed a version of the Uniform Act. This subsection is confined to real property located within Florida (since presumably the law of the

[33] Fla. Stat. §§ 732.216 – 732.228.

situs of the property will govern dispositive rights), subject to the aforementioned exceptions. The policy and operation of this subsection are intended to be the same as those set forth in the subsection dealing with personal property.

Example from the UDCPRDA. H and W, while domiciled in California, purchased a residence in California. They retained the residence in California when they moved to Wisconsin. After becoming domiciled in Wisconsin they used community funds, drawn from a bank account in California, to purchase a Wisconsin cottage. H and W subsequently became domiciled in Florida; they then purchased a condominium in Florida (titled in H's name and not as TBE property) for $200,000 using $150,000 of community property funds drawn from their bank account in California and $50,000 earned by H after the move to Florida. H died domiciled in Florida; title to all of the real property was in H's name. Since Florida has enacted the Uniform Act, three-fourths of the Florida condominium would be property subject to the Act; the Florida statute would not, however, apply to either the Wisconsin or California real estate.

(c) Fla. Stat. § 732.218. Rebuttable presumptions. Rebuttable presumptions apply which presume the applicability of community property rights for married persons who bring traceable community property into Florida. The purpose of the rebuttable presumptions is to assist a Florida court in applying the definitions in Section 732.217, through a process of tracing the property to a community property origin.

(i) Subsection (1) of this Section deals with property acquired by the spouses while domiciled in a community property state. It thus provides that if one of the spouses acquired property while so domiciled, those assets are "presumed" (a rebuttable presumption) to have been and remained community property. It may be shown, however, that such property was the separate property of the spouse and the law of the state of domicile may provide the rule. For example, the law of community domicile may provide the rule that property acquired in the name of the wife shall be deemed to be her separate property or that a particular subsequent act effectively severed the community property interest.

Example from the UDCPRDA. H, married to W and domiciled in California, acquired stock; later H and W became domiciled in Florida. Such property, if retained, is presumed to be property subject to the Florida Uniform Act. By operation of Section 732.217, the proceeds of sale or exchange of such stock, and property acquired with the proceeds or income of such stock, would be deemed subject to the Florida Uniform Act. If, however, upon the death of H, H's personal representative rebutted the presumption by evidence that the stock was acquired by H with his separate property (or by inheritance), neither the stock nor property acquired with that property or the income therefrom (unless the income itself would be subject to the Act because, under the applicable law, income from separate property is deemed to be community property), would be subject to the Florida Uniform Act. Similarly, the presumption may be rebutted by showing that such property, though originally community property, was effectively severed by an act of the spouses. It should be emphasized that the presumption is simply one of procedural convenience and neither changes the nature of the property interests nor prevents an interested person from showing the separate nature of the property.

(ii) Subsection (2) of this Section sets up a rebuttable presumption that where Florida property is acquired in such form as to indicate that title was in joint tenancy, tenancy by the entireties, or some other form of joint ownership with right of survivorship (or was homestead property), it will be presumed that the property is not subject to the Florida Uniform Act. This presumption was deemed appropriate as expressing the normal expectations of the spouses and to facilitate ascertainment of title to real property located in Florida, as well as personal property wherever located.

Example from the UDCPRDA. John and Mary Jones, formerly domiciled in California, became domiciled in Florida and purchased a residence, taking title in the names of "John and Mary Jones as joint tenants, and not as tenants in common, with right of survivorship." Regardless of the source of the funds, the Florida residence would be presumed to be held in joint tenancy and not subject to the Florida Uniform Act.

(d) Fla. Stat. § 732.219. Disposition upon death. Upon the death of a Florida resident who has rights in community property, ½ of the community property is included in the decedent's estate as the individually owned property of the decedent, and the remaining ½ of the community property is owned by the surviving spouse (and thus not subject to testamentary disposition by the decedent or distributions under Florida intestacy laws). This section deals with the dispositive rights, at death, of (1) a married person domiciled in Florida as to personal property and (2) any married person, including a nondomiciliary of Florida, as to real property located in Florida.

With respect to property to which the Florida Uniform Act applies, the ½ of the property which is the property of the decedent is not subject to the surviving spouse's right to an elective share.[34] Policy reasons suggest a denial of any right in the surviving spouse to elect against decedent's share of the community estate since the surviving spouse already has a ½ interest in the property subject to the Florida Uniform Act.

(e) Fla. Stat. § 732.221. Perfection of title of personal representative or beneficiary. If any community property is titled in the name of the surviving spouse at the time of the other spouse's death, the Personal Representative or a beneficiary of the decedent's estate may institute an action to perfect title to the community property. A Personal Representative has no fiduciary duty to discover or attempt to discover whether any property held by the surviving spouse is community property unless a written demand is made by (1) a beneficiary within 3 months after service of a copy of the notice of administration on the beneficiary or (2) a creditor within 3 months after the first publication of the notice to creditors.

(f) Fla. Stat. § 732.222. Purchaser for value or lender. Section 732.222 is designed to protect purchasers and lenders taking a security interest, who acquire such interest for value after the death of the decedent, from a person who appears to have title to property

[34] Real property in another state that is considered community property and the decedent's ½ interest in any other community property no matter where located is excluded from the elective estate pursuant to Fla. Stat. § 732.2045(1)(f). However, if the decedent's interest in the community property passes to the surviving spouse, it does count towards satisfying the elective share under Fla. Stat. § 732.2075(1)(c).

to which the Florida Uniform Act applies. The only requirement is that the purchaser or lender have acquired the interest for value; there is no requirement of good faith absence of notice. The purpose of the Section is to permit reliance upon apparent title and facilitate both ascertainment of title and disposition of assets where adequate consideration is paid. Since, during the joint lives of the spouses, the spouse with apparent title would have been able to convey title (at least as to community property), though being held accountable to the other spouse for an appropriate allocation of the proceeds or any breach of fiduciary obligation, the Florida Uniform Act simply extends this treatment to disposition of the assets after the death of the spouse. This does not change (1) the rights and duties of the surviving spouse or the Personal Representative as it relates to the proceeds of the sale or loan procedure, or (2) the community property status as to any other person other than the deemed bona-fide purchaser.

(g) Fla. Stat. § 732.223. Perfection of title of surviving spouse. Section 732.223 provides for perfection of title interests of the surviving spouse (e.g., where title was in the name of the deceased spouse) by orders of the Florida probate court. This section is designed to eliminate any liability of the personal representative for a breach of fiduciary duty by failing to search for or to discover whether property held by the decedent is community property, unless a written demand is made by the surviving spouse or the spouse's successor in interest. This section is similarly designed to eliminate the probate court's duty to discover community rights and to advise interested parties of their rights. Nothing contained in this section is to be construed to interfere with the probate court's jurisdiction in a proper proceeding to perfect the title of the surviving spouse in and to property to which the Florida Uniform Act applies.

(h) Fla. Stat. § 732.224. Creditor's rights. This section provides that the Florida Uniform Act does not affect rights of creditors with respect to property to which the Act applies. The purpose of the section is to try to prevent fraud against creditors through the exercise of community property rights (i.e., allow creditors to follow apparent title of record and not be limited to community property). This is a long-standing legal concept in most community property jurisdictions.

(i) Fla. Stat. § 732.225. Acts of married persons. The rights and procedures with respect to severance of community property vary markedly among the community property states. The first part of this section simply makes clear that nothing in the Florida Uniform Act itself in any way limits the rights of the spouses to sever community property or to create a form of ownership not subject to this Act. The second part of this section is specific to Florida. It provides that if community property proceeds are reinvested in real property located in Florida which is or becomes Florida homestead property, then a *conclusive*[35] presumption is created that the spouses have agreed to terminate the community property attribute of the reinvested property.

A full overview and discussion of issues relating to the tenancy by the entireties and homestead exceptions contained in the Florida Uniform Act are beyond the scope of this outline. And by "beyond the scope of this outline," I really mean that I do not believe that the presentations and materials of Richard Warner, a trusts and estates practitioner in Marathon, Florida, on this

[35] Query whether the Florida Legislature can create a conclusive (and not rebuttable) presumption. This may be unconstitutional.

subject can be improved on. Mr. Warner's materials should be reviewed for an in-depth discussion of these exceptions and the issues that they present.[36]

(j) Fla. Stat. § 732.226. Limitations on testamentary disposition. The Florida Uniform Act does not authorize a decedent to dispose of property by will if it is held under limitations imposed by law preventing testamentary disposition by the decedent.

(k) Fla. Stat. § 732.227. Homestead defined. For purposes of the Florida Uniform Act, "homestead" refers only to property the descendant and devise of which is restricted by s. 4(c), Art. X of the Florida Constitution (i.e., protected homestead).

3. *Johnson v. Townsend.* A recent Fourth District Court of Appeals case illustrates the uncertainty surrounding the application of the Florida Uniform Act and its effect on Florida residents who move to our state with community property. In *Johnson v. Townsend*[37], a married couple moved to Florida from Texas (a community property state). When the husband died in January 2015, he was survived by his wife and children from a prior marriage. In March 2015, the husband's will was admitted to probate and his wife was appointed personal representative. In September 2017 (over two and a half years after the husband's death), the wife filed a claim under the Florida Uniform Act seeking to receive her one-half interest in the community property acquired while the couple were residents of Texas. The Fourth District Court of Appeals ruled that the wife's claim was a creditor claim which was subject to the two-year statute of repose contained in the Florida Probate Code. The wife was therefore barred from receiving her one-half interest in the community property since she did not file a timely creditor claim. Many Florida practitioners disagree with this result.[38] Regardless of whether or not this case was correctly decided, *Johnson v. Townsend* clearly illustrates the ambiguities contained in the Florida Uniform Act and that current law regarding the treatment of community property in Florida is a potential trap for the unwary.

C. Additional Issues for Florida Attorneys Dealing with Community Property. Addressing community property or community property rights with Florida residents brings up many unique issues in the planning process. The following are some of the issues that may face Florida attorneys addressing community property issues:

1. When addressing community property issues for clients, Florida attorneys must examine the laws of the community property state or states in which the couple resided before changing their domicile to Florida, due to the state-specific nature of these statutes. The

[36] See, for example, Mr. Warner's outline, "Playing Both Sides of the Florida Community Property Street?" A copy of that outline can be downloaded at www.epc.miami.org/assets/Councils/GreaterMiami-FL/library/Richard%20Warner%20Presentation%20-%201.8.15.pdf

[37] 259 So.3d 851 (Fla. 3rd DCA 2018).

[38] The RPPTL Section's Probate Law and Procedure Committee has empaneled a subcommittee to look at this issue to determine whether the Florida Uniform Act needs to be revised to address the ruling in *Johnson v. Townsend*.

comparison chart contained in IRS Manual 25.18.1 is a good resource for practitioners when attempting to determine the specifics of the various state community property laws.

2. Unfamiliarity with community property law on the part of a Florida attorney can lead to a change in the character of the property from community property to a survivorship form of ownership that is not desired by the clients and that can negatively affect their estate plan. It is therefore of the utmost importance that practitioners identify and know how to address clients' community property or community property rights which are brought into Florida.

3. There is no change to creditors' rights in community property when a married couple moves to Florida. An attorney should review the laws relating to the rights of creditors in the former state of domicile.

4. There is an inherent conflict of interest when advising spouses to change the character of their property. If advising a couple on the classification of their property, possible commingling, tracing or titling issues, or any other community property-related issue, the attorney must clarify the waiver of the conflict with engagement letters and obtain client informed consent of both spouses after consultation and disclosure as required by MRPC Rule 1.7, if the attorney will represent both spouses.

5. The failure of an attorney to adequately research community property issues in estate planning or divorce situations has been held to constitute malpractice.[39] Additionally, the Florida Uniform Act does not protect attorneys who do not attempt to locate and identify community property after a decedent's death. (While the Florida Uniform Act does provided this protection to the personal representative of the estate, the same protection is not extended to the personal representative's attorney.[40])

6. If transferring real property to an out-of-state community property trust, it may be preferable to contribute the real estate to a limited liability company, and then transfer the membership interest to the community property trust. This would avoid questions of the nature of the non-situs real property within the trust.

7. While beyond the scope of this outline, specific issues arise when dealing with community property rights in beneficiary designated assets, such as life insurance and retirement accounts. An attorney should consider having the non-owner spouse waive his or her community property rights in beneficiary designated assets, if the couple has not already agreed to same in a community property agreement executed in the former domiciliary state.

8. Litigators should also be aware of the laws relating to community property and community property rights, as these issues could result in differing outcomes of a case. The determination of the community property status can affect a client's rights in and entitlement to

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[39] See *Smith v. Lewis*, 530 P.2d 589 (Cal. 1975); *In re Marriage of Brown*, 544 P.2d 561 (1976); *Aloy v. Mash*, 696 P.2d 656 (Cal. 1985).

[40] See Fla. Stat. § 732.221.

property. For example, in a dispute involving a second spouse and children from the prior marriage where the couple previously resided in a community property jurisdiction, the determination of whether property was community property or the separate property of the decedent can have a significant effect on who receives the property.[41] The same is true if the litigator is representing a creditor or defending a creditor's claim in an estate. The determination of whether an asset was community property will affect the outcome of the creditor's rights. Community property rights are also important in disputed elective share, homestead, and other spousal entitlement cases.

9. If doing a "Florida update" to a trust which contains community property from another state, the practitioner should include a statement of intent in the new document. The following is a sample provision:

"We were formerly residents of the State of Arizona, a community property state. We hereby affirm the community property character of any assets held by or added to the August 27, 2012 Agreement which were acquired by either of us, during our marriage, while we were residents of the State of Arizona, and which then constituted community property. We also affirm the separate property character of any assets added to the August 27, 2012 Agreement which then constituted separate property. The execution, funding and/or administration of the August 27, 2012 Agreement, including the execution of this Amendment, shall not alter the character of any such community property or separate property. Any income earned or accrued by the August 27, 2012 Agreement shall have the same character as the property to which such income relates, whether or not such income is later added to trust principal. Any property distributed from the August 27, 2012 Agreement while we are both living shall have the same character as such property had prior to its addition to the August 27, 2012 Agreement. The Trustees may rely upon any certification made by either of us as to the community property or separate property character of any property held by or added to the August 27, 2012 Agreement. If there is a doubt as to the character of any trust asset, any asset acquired by either one or both of us, during our marriage, while we were resident in a community property state, shall be presumed to be community property; otherwise, such asset shall be presumed to be separate property. During our respective lifetimes, the Trustees shall have no more extensive power over any community property transferred to the August 27, 2012 Agreement than either of us had under the law of the State of Arizona at the time we acquired such community property.

10. Many of these issues may now be addressed by establishing a Florida Community Property Trust, which Florida practitioners are now allowed to do!

[41] For example, if an asset of the decedent is determined to be community property (or was purchased with the proceeds from community property), then ½ of that property is deemed to be owned by the surviving spouse and not subject to devise by the decedent. However, if the children from the prior marriage prove that the subject asset was the separate property of the decedent (whether by agreement, commingling, transmutation, or otherwise), then the decedent could devise the asset to the children and the surviving spouse would not have a legally entitled interest in the property.

IV. IRS TREATMENT OF COMMUNITY PROPERTY (OR COMMUNITY PROPERTY RIGHTS) HELD BY FLORIDA RESIDENTS

"It has been established that what constitutes an interest in property held by a person with a State is a matter of State law… On the other hand, once property rights are determined under State law, Federal law is utilized to decide the tax consequences."[42]

There has been much debate among practitioners regarding whether community property brought into a common law state remains community property, whether the community property rights follow the property into the common law state, and whether the IRS will respect the claim that a decedent dying in a common law state retained community property "under the community property laws of any State". Since the IRS has yet to rule on this issue or challenge the community property characterization under a UDCPRDA state, there is not a clear answer to these questions. There are, however, valid arguments to be made for both sides.

A. Effect of the Florida Uniform Act. The single biggest question relating to the treatment of community property in Florida is whether the Florida Uniform Act preserves the character of previously acquired community property for purposes of the full step-up in basis under IRC § 1014(b)(6). The outcome is not fully clear when taxpayers move from a community property state to a common law state which has adopted a version of the UDCPRDA. To date, the IRS has seemed to follow the plain language of IRC § 1014(b)(6) in finding that the full step-up is permitted.[43]

1. Arguments in Favor of the Florida Uniform Act Allowing for Full Basis Step-Up.

(a) There is some authority indicating that the IRS will allow the full step-up in basis for former community property in UDCPRDA states. This was the conclusion reached in the Field Service Advisory (FSA), cited in FN 42, treating property held in the UDCPRDA state of Oregon as community in nature. The FSA provided that "under Oregon law, property to which the Uniform Act applies retains its character as community property although the property is situated in Oregon, a noncommunity property state." The FSA stated that "[i]n all cases, the controlling factor is the characterization of the property under state law," which allowed the full step-up in basis under IRC § 1014(b)(6). It appears that the IRS is stating that if former community property is disposed of as community property, its character as community property has been preserved for purposes of IRC § 1014(b)(6). At present, the IRS has at least indicated that it does consider that the UDCPRDA preserves the character of community property upon a move to an adopting common law state, and thus should allow the application of IRC § 1014(b)(6).

[42] *Estate of Young v. Commissioner*, 110 T.C. 297, 300 (1998).

[43] 1993 WL 1609164 (IRS FSA).

(b) The Florida Uniform Act provides that imported community property rights attach to Florida property.[44] This should arguably qualify as a "community property law of any State." Therefore, Fla. Stat. 732.217 should cause the imported community property to fit within the plain meaning of IRC § 1014(b)(6).

(c) The fact that the Florida Uniform Act is only operative at death is likely irrelevant. In *Murphy v. Commissioner*[45], a married couple converted real estate from community property to tenancy in common and later sought to invoke IRC § 1014(b)(6) at the first spouse's death. The Ninth Circuit held that IRC § 1014(b)(6) does not apply to property that was, at some past time, held as community property, and the only characterization of property that matters for IRC § 1014(b)(6) purposes is the characterization at death. Therefore, *Murphy* can be read to provide that the Florida Uniform Act treating property as community in nature at death (even though it does not address lifetime community property rights) is sufficient for qualification for the full step-up in basis.

(d) Case law has long provided that Florida must recognize the rights of a person in community property. The community property rights imported into Florida should be identical to the original rights the couple had in the community property jurisdiction (to the extent that there is not a limitation based on a Florida public policy, such as possibly with creditor rights). *Colclazier v. Colclazier*[46] set forth the manner in which community property rights are brought into Florida, and that such rights are recognized and protected under Florida law. The recognition of these imported rights in community property in the State of Florida was described in greater detail in the previously cited *Quintana* case. The Third District Court of Appeal reaffirmed the prevailing view in Florida that community property rights follow a married person coming from a community property jurisdiction into Florida and must be protected in the same manner as common law property rights of married couples in Florida. *Quintana* cited to numerous cases[47] from community property jurisdictions which have held that community property rights are vested and constitutionally protected. To find otherwise would raise constitutional issues relating to full faith and credit, equal protection, and interstate commerce.

2. Arguments Against Florida Uniform Act Allowing for Full Basis Step-Up.

(a) The Florida Uniform Act does not state that it preserves the community property character of such property; it only causes it to be disposed of in a similar manner at death. It also is only applicable at death and does not purport to affect property during the lives of the spouses. It could therefore be argued that the Florida Uniform Act does not

[44] Fla. Stat. § 732.217.

[45] 342 F. 2d 356 (9th Cir. 1965).

[46] 89 So.2d 261 (Fla. 1956).

[47] The most commonly cited case setting forth this principle is *Estate of Thornton*, 33 P.2d 1 (Cal. 1934).

preserve the full step-up in basis since the Act does not explicitly claim to preserve the community character of the property.

(b) Florida law does not allow the creation of community property rights (unless held in a Florida Community Property Trust, as discussed below); it only allows the importation of these rights from other states. Therefore, it could be argued that the Florida Uniform Act does not meet the criteria of IRC § 1014(b)(6).

(c) While the previously cited FSA seems supportive of the Florida Uniform Act allowing for the full basis step-up, some practitioners caution relying it. A FSA cannot be used as precedent. Also, some argue that the logic is faulty and the result is surprising since the UDCPRDA does not purport to preserve the character of that subject property as community property.

3. Again, many of these issues may now be addressed by establishing a Florida Community Property Trust, which Florida practitioners are now allowed to do!

B. Effectiveness of Agreements Entered into in Community Property States. Couples in community property states can enter into agreements to treat all of their property as community property, effectively transmuting all their separate property to community property under state law. Using this type of agreement, the taxpayer has the power to create more community property than the state would otherwise create, yet community property created by such an agreement is clearly community property "under the community property laws of any State." These agreements could also provide that the couple agree that community property will not be transmuted to separate property under any circumstances, including in the event of a move to a common law state, such as Florida. There is evidence to suggest that the IRS accepts such agreements as effective transmutations and classifications for purposes of IRC § 1014(b)(6).

1. Case Law. Case law suggests that the courts will consider agreements classifying property as community in nature to be effective for purposes of the full step-up in basis. Courts generally find such agreements effective for purposes of other federal taxes. In *Bank of America National Trust and Savings Association v. Commissioner*[48], the predecessor to the Tax Court found a universal community property agreement transmutation valid for purpose of the federal estate tax because the agreement effectively transmuted assets to community property under California law. A similar conclusion was reach with respect to the federal gift tax in *Damner v. Commissioner*.[49]

2. IRS Rulings. Revenue Ruling 87-98 supports the position that the Service will allow the full step-up in basis for community property whose classification is transmuted or solidified pursuant to agreement between spouses. Two other IRS pronouncements also strongly suggest that the Service accepts the transmutation of the classification of property through a

[48] 43 B.T.A. 695 (1941). See *also Estate of Young v. Comm'r*, 1101 T.C. 297) (1998) (holding that in general, property may be transmuted by agreement for purposes of the federal estate tax).

[49] 3 T.C. 638 (1944) (California)

community property agreement for purposes of IRC § 1014(b)(6). In Revenue Ruling 77-359, the IRS ruled on the effect of such an agreement for federal income tax purposes for couples domiciled in Washington. The IRS ruled that "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." While this addressed community property agreements for purposes of federal income tax, it should apply for purposes of IRC § 1014(b)(6) since that section is part of the income tax provisions of the Internal Revenue Code. Also, the ruling is in line with the plain meaning of IRC 1014(b)(6) since the laws of Washington bless such agreements and the effectiveness of the present and future transmutation of property. The plain meaning interpretation is further supported by Private Letter Ruling 9917025.

3. Frequent Usage. Community property agreements are frequently recommended by estate planners as a means of transmuting separate property into community property for purposes of IRC § 1014(b)(6), as well as maintaining the community property status. Since the practice is so common and there are no reported cases or ruling where the IRS has challenged the validity of such agreements, it appears that the IRS does not wish to contest it.

4. Application in Florida. Based on the foregoing, it would appear that if a couple executed a community property agreement under the laws of the former community property jurisdiction which provided that assets were to be treated as and remain classified as community property, then the agreement as to the community property status should continue to be effective even after a move to a common law jurisdiction, such as Florida.

C. Commingling of Separate and Community Property. Under most state laws, commingling of separate and community property typically transmutes the separate property into community property. The IRS has not spoken as to whether this taxpayer-created community property will qualify for the full step-up in basis. However, a number of factors suggest that the IRS will recognize transmuted community property for § 1014(b)(6) purposes.

1. Case Law. A number of courts have presumed the validity of commingling transmutations for other federal tax purposes. In *Sweeney v. Commissioner*[50], an estate tax inclusion case, the predecessor of the Tax Court wrote that "where separate and community property have become so intermingled, commingled and merged as to make segregation difficult or impossible, the whole is treated as community property… In consideration both of the commingling of the property and of the express agreement between the parties, we hold that the entire property formerly owned by the decedent and [the wife of the decedent] … was community property." The Tax Court came to a similar conclusion regarding the federal gift tax in the previously cited *Damner* case. So for purposes of the federal estate and gift taxes, commingling seems to be an effective means of transmutation of separate property into community property. While there are no cases specifically addressing the effectiveness of commingling transmutations for purposes of IRC § 1014(b)(6), *Sweeney* and *Damner* suggest that the courts would find

[50] 15 B.T.A. 1287 (1929).

commingling to be an effective means of transmutation for purposes of this section of the Internal Revenue Code as well.

2. Strict Construction of Statute. Commingling transmutations seem to fit within the plain meaning of IRC § 1014(b)(6). The section only requires that property be considered community property "under the laws of any State…" Commingling clearly transmutes the character of separate property to community property in certain states.[51] In the past, the IRS has appeared to adhere strongly to the plain meaning of the statute. In Revenue Ruling 87-98, the Service addressed a situation in which a couple domiciled in a community property state took title to real estate as joint tenants with rights of survivorship. This raised a presumption of transmutation from community to separate property under state law. However, since the couple had indicated in their wills that they considered the property to be community property, the presumption was overcome under applicable state law. Even though the title to the property indicated separate ownership (since joint tenants with rights of survivorship is a common law form of separate property ownership), the IRS held that "[b]ecause it is community property under state law, it is also community property within the meaning of section 1014(b)(6)." So even in a case where the IRS could have argued that the property was separate property according to the real property titling, it adhered strictly to the state law characterization of the property as community and allowed the full step-up in basis. The same reasoning should apply to commingled separate property which has been transmuted to community property.

3. Application in Florida. It is possible that assets would lose their community property status if commingled with Florida separate property. However, Revenue Ruling 87-98 may provide an argument that the commingled assets can remain community property if the married couple has otherwise indicated this intent.

V. COMMUNITY PROPERTY TRUSTS

Five states, Alaska, Tennessee, South Dakota, Kentucky and now Florida, currently provide that property acquired by a married couple is separate property, but allow the couple to elect to treat it as community property if transferred to and held in a Community Property Trust. This is in contrast with the general rule in most community property states that all property acquired by a couple is community property unless they have clearly provided to the contrary. Alaska, Tennessee, South Dakota, Kentucky and Florida permit the creation of a trust to hold property and community property, and treat the assets held in the trust as community property (even if the couple do not reside within the state).

A. Community Property Trust Statutes. The laws of all of the "community property trust states" have been created legislatively and have specific statutes authorizing the creation of community property if held in a specific type of trust. The community property trust statutes for the five states which have enacted legislation are very similar and have many of the same provisions and requirements. The primary difference among the statutes is that South Dakota refers to community property as "special spousal property" and community property trusts as

[51] See, e.g., *Stoutz v. United States*, 324 F.Supp. 197 (E.D. La. 1970) (Louisiana); *Houska v. Houska*, 512 P.2d 1317 (Idaho 1973).

"Special Spousal Trusts." This nomenclature is specific to South Dakota and is not used in other states' statutes (including Florida). The Florida, Kentucky and South Dakota acts, being the most recently enacted, also contain some additional provisions not found in the older Alaska and Tennessee statutes, primarily a specific statement that the laws comply with the requirements of IRC § 1014(b)(6). The Florida statute also contains Florida-specific provisions, which are discussed in detail in Section VI of this outline. But generally speaking, all five of the community property trust states statutes are analogous, which is important in that you may be able to look to other states' laws, court decisions, and IRS rulings, even when dealing with a community property trust from a different states (similar to how Uniform Laws are treated).

B. Will Community Property Trusts be Respected by the IRS?

1. *Commissioner v. Harmon*. During the 1940s, some states[52] enacted laws allowing residents to opt-in to community property treatment of assets. In *Commissioner v. Harmon*,[53] the United States Supreme Court ruled that an Oklahoma statute allowing spouses to elect community property treatment under that state's law would not be recognized for federal income tax reporting. Some argue that the IRS, while it has not done so to date, will rely on the ruling in *Harmon* to disallow the full step-up in basis for community property acquired through an opt-in community property state, such as Alaska, Tennessee, South Dakota, Kentucky or Florida.

However, many practitioners believe that the *Harmon* decision does not affect the community property classification under an opt-in system. In Revenue Ruling 77-359, the IRS concluded that the conversion of separate property to community property by residents of a community property state would be effective for gift tax purposes while ineffective for the transmutation of income from such property. Based on this Revenue Ruling, it appears that the IRS will treat the underlying property as community property and will not distinguish between elective and default community property regimes (unless it is for purposes of income splitting). Many practitioners believe that the income splitting is the key distinguishing factor between the legislation at issue in *Harmon* and the use of modern-day community property trust statutes, and thus why the IRS has not tried to apply the *Harmon* ruling to disallow the double-step up with respect to community property trust assets. But it is an issue that well-versed practitioners should keep in the back of their mind when recommending and using community property trusts.

2. Due Process. Section 1 of the 14th Amendment of the United States Constitution provides in part "nor shall any State deprive any person of life, liberty, or property, without due process of law." A move across state lines cannot deprive a spouse of the vested property rights the spouse has under the laws of community property because there would be no due process to cause the change. Similarly, under basic conflict of laws principles, a right belonging to either or both spouses in property is not affected by a change in domicile by the couple to a different state.[54] Arguably, this should apply to clients who move to a different state

[52] Hawaii, Michigan, Nebraska, Oklahoma, Oregon and Pennsylvania.

[53] 323 U.S. 44 (1944).

[54] See Restatement (Second) Conflict of Laws § 259.

with community property and want to use a community property trust to ensure and confirm that the community property retains its status as such.

3. Application of Basis Rules. IRS Publication 555[55] (entitled "Community Property"), most recently revised and released in 2016, does not consider "the federal tax treatment of income or property subject to the 'community property' election under Alaska state laws." IRS Publication 555 only speaks to Alaska's opt-in community property regime, and not to the efficacy of Alaska community property trusts. The IRS may view these type of community property systems as providing too much flexibility to the taxpayers to opt in and out of community property status, and that the Alaska-type system is more akin to a tax avoidance ploy rather than a state property law system. With that being said, no reported cases or IRS rulings have addressed the federal income tax capital gains basis step-up for property held in a community property trust established in Alaska, Tennessee or South Dakota. Also, no known challenges have been made to the community property classifications in these states for income tax purposes, despite those statutes being "on the books" for several years. Furthermore, practitioners in those states have indicated that they have had numerous clients pass away with community property trusts and the double-step up issue was never addressed on audit.

4. Opt-in v. Opt-Out. Some practitioners have suggested that a state cannot allow an opt-in to community property treatment for purposes of IRC § 1014(b)(6) (based mostly on the ruling in *Harmon*), but in each of the nine states where community property is the default, spouses may opt out of the community property regime by agreement. To allow spouses to opt-in, where separate property is the default, should be considered the same way. However, IRS Publication 555 specifically states that "[t]his publication does not address the federal tax treatment of income or property subject to the 'community property' election under Alaska state laws." Some argue that the clear implication, which would be consistent with *Harmon*, is that the IRS will not recognize elective community property laws for federal income tax purposes (although the IRS has never raised the issue).

C. Florida Community Property Trusts? Several years ago, Florida began to consider legislation that would allow surviving spouses who have property passing through a Florida community property trust to receive a 100% step-up in basis on that property for federal income tax purposes, thus creating a benefit similar to that of surviving spouses in community property states. There are numerous reasons that such legislation would be beneficial to Florida residents. Also, many public policies of Florida and some facets of Florida law already seem to support this type of legislation.

1. Who Could Benefit from Florida Community Property Trusts? Based on the uncertainties involved with Florida community property rights and the potential that the IRS will deny the full step-up in basis for community property (or community property proceeds) brought into Florida, married couples moving to Florida from community property jurisdictions would be the most obvious beneficiaries from this type of legislation. Community property trusts would also be advantageous for Florida married couples whose assets are not currently deemed to be community property, but have one or more of the following characteristics: (1) a long-term

[55] Internal Rev. Serv., Cat. No. 15103C, Community Property (Rev. 2016).

stable marriage[56] (so that the trust will truly get the step-up at death; although the trust may also function as to trust property as a postnuptial agreement on dissolution of the marriage, that is not its primary intent); (2) the couple has highly appreciated property, stocks or real estate (owned by one or both spouses); (3) an over-weighted financial portfolio that the couple has delayed selling because of exposure to capital gains tax; (4) rental real estate or other real property that the surviving spouse would not want to manage and may immediately want to sell; (5) property that could benefit from the 100% step-up in basis, such as those who own self-created intellectual property, negative basis, highly depreciated property, gold, artwork, or other collectibles (which may be subject to a minimum 28% long-term capital gain rate); and/or (6) no present or foreseeable creditor concerns.[57]

Even if a Florida couple does meet some of the criteria, it is important to keep in mind that not all of the couple's property has to be transferred to the community property trust. Or the couple can declare in the trust agreement that certain property is not to be considered community property, allowing them to pick and choose the nature of the assets. This is actually a benefit of community property trust legislation over opt-out community property regime.

2. What are Some Benefits Provided by Florida Community Property Trusts?

(a) More Clarity Regarding Full Step-Up in Basis. While there is still some uncertainty regarding the IRS' treatment of community property held in opt-in community property trusts, the community property trust platform would still provide more clarity and certainty than relying on Florida's version of the UDCPRDA for the reasons previously identified and discussed.

(b) Evening the Playing Field with Community Property State Residents. With respect to the benefits of federal income tax laws' step-up in basis, Florida allowing the creation of Florida community property trusts would equalize the benefits of Florida married couples to those in community property states, regardless of the property regimes the states have adopted or on which European countries their property laws were based.

(c) Simplicity. Allowing Florida residents to transfer assets to a Florida community property trust would simplify the estate planning process for many clients. For example, there would not be a need to equalize the couple's assets between the spouses (although the need for this has been reduced in some cases because of the enactment of portability). It would give planners a simpler method to divide assets between spouses if necessary to fund a trust for estate planning purposes, such as tax planning and long-term care planning, while also obtaining the tax benefits afforded community property. Income tax basis planning would also be much easier to accomplish (e.g., this would be an alternative to trying to transfer low-basis stock to

[56] Second marriage clients with children from a prior marriage are likely not good candidates for a community property trust, since they will likely want to keep property separate.

[57] Spouses with asset protection concerns, high liability professions, etc. would not likely be good candidates due to the increased creditor exposure of community property.

spouse most likely to be the first to die to get the step-up). Additionally, there would not be the temptation to implement other types of untested and more complicated trusts which attempt to achieve the full step-up in basis, including joint exempt step-up trusts (JESTs) and step-up grantor retained interest trusts (SUGRITs).

(d) No Need for Tracing. If a Florida couple utilized a Florida community property trust, there would be a clear bifurcation between community and separate property. Currently, community property rights for Florida residents requires tracing in order to identify community property and to quantify the amount of community property versus separate property. This can be labor intensive and could in essence turn into a forensic accounting project. In making the required community versus separate property determination, the attorney also needs to ascertain how the property is treated under the laws of the couple's prior community property jurisdiction as part of the tracing process. (Again, refer to attachment from IRS Manual 25.18.1 for a synopsis of the various states' community property laws.) Allowing a Florida couple's community property to be segregated in a Florida community property trust will alleviate (if not eliminate) the need for the time-consuming tracing process.

(e) Evidence of Couples' Intent. If a Florida couple transfer assets to a Florida community property trust, it makes it very evident that they wish for those assets to be treated as the couples' community property and to acquire the rights (and to relinquish others) associated with this type of property classification. This evidence of the couples' intent should diminish post-death litigation regarding whether property is community or separate.

(f) Not Turning Existing Florida Law on Its Head. Allowing Florida residents to create Florida community property trusts would not upset or drastically change existing Florida law. Florida law contemplates that some residents will establish joint revocable trusts as part of their estate planning. Through the enactment of the Florida Uniform Act, Florida has already attempted to recognize community property rights for purposes of descent and devise. Florida law has a well-established body of statutory and common law governing the administration of trusts which would apply to Florida community property trusts, with little to no change. Florida probate administration would not be effected. In summary, permitting the use of Florida community property trusts by Florida residents would really only change federal tax law treatment, not well-established Florida law.

3. Florida Public Policies Supporting Florida Community Property Trusts.

(a) Testamentary Freedom and Intent. Florida case law has long recognized the constitutional right of Florida residents to dispose of property in the manner they see fit.[58] It would seem that Florida public policy allows Florida residents to dispose of their property in the manner they see fit (as long as it does not conflict with another public policy, such as disinheriting your spouse), which should include transferring property to a community property trust and electing for the transferred assets to be treated as community property.

[58] See *Shriners Hospitals v. Zrillac*, 563 So.2d 64 (Fla. 1990).

(b) Protecting Surviving Spouses. Florida clearly has a strong public policy of protecting surviving spouses, as can be seen in our elective share, pretermitted spouse, protected homestead, and spousal allowance statutes, just to name a few, as well as a well-established body of case law.[59] Some commentators conclude that the policy of facilitating marriage as an equal economic partnership for the purpose of transfers to a trust is a strong advantage to this type of trust, in addition to the federal income tax benefit. A surviving spouse would have a 50% ownership interest in a community property trust (which exceeds what he or she would get through an elective share action), so this should support the fact that community property trusts further Florida's public policy of protecting surviving spouses.

(c) Acknowledgement of Validity and Usage of Nuptial Agreements. Florida has long acknowledged the validity and use of nuptial agreements to establish the rights of spouses in property. It has even been incorporated into the Florida Probate Code in Fla. Stat. §§ 732.701 and 732.702. When viewed as another form of a postnuptial agreement, Florida public policy would seem to support the use of community property trusts as a valid agreement between spouses regarding the disposition of their assets.

(d) Other Types of Spousal Trusts in Florida. Florida case and statutory law validate the use of various types of trusts to provide for spouses. In particular, the Florida legislature amended Fla. Stat. § 736.0505 in 2010 to explicitly recognize the validity of inter vivos QTIP trusts. A common purpose of using an inter vivos QTIP trust is to allow a wealthier spouse to pass assets to the spouse with less assets so that each spouse can take maximum advantage of their respective estate tax exclusions. The spouse with less assets gets the benefit of having those assets available to him or her in trust. This does not seem to be far off from the purposes of using a community property trust. In addition, inter vivos QTIP trusts are in essence self-settled trusts, even though Florida has refused to enact self-settled trust legislation. It can therefore be inferred that the public policies of providing for a spouse and allowing couples to dispose of in the manner they see fit (in this case transferring assets for estate tax planning) trump Florida's public policy against self-settled trusts, which should be a strong argument in support of the enactment of community property trust legislation.

4. Risks Associated with Florida Community Property Trusts. While there could be substantial benefits to Florida residents from the enacted community property trust legislation, the use of this technique does not come without risk.

(a) Step-Down in Basis. Pursuant to IRC §1014, basis is adjusted to the fair market value of the property included in the decedent's estate as of the date of death (or in some cases, as of the date of the alternate valuation date). While this outline has focused on the benefits of a full step-up in basis under IRC § 1014(b)(6), if the subject assets have a built-in capital loss at death, then those assets would actually receive a step-down in basis. If another market crash were to occur, decedents owning community property would be in a worse position than decedents in common law jurisdictions since all of the married couple's property would receive a step-down in basis.

[59] See *Via v. Putnam*, 656 So.2d 460 (Fla. 1995); *In re Estate of Magee*, 988 So.2d 1 (2nd DCA 2007).

(b) Step-Up in Basis not Permitted by IRS. As previously discussed, it is possible that the IRS will eventually decide to challenge community property trusts established in states that allow residents to opt-in to community property characterization through the use of such trusts. So clients could go through the hassle and expense of this type of planning, only to see the IRS rule that the income tax benefits they thought they would receive are not available or recognized. Also, as with all transfers made in contemplation of imminent death, there is a risk under IRC § 1014(e) of not receiving the 100% step-up in basis with a deathbed transfer. Also, the federal government could eliminate the step-up in basis through enacted tax legislation, as is currently being proposed by the Biden administration.

(c) Creditor Risks. As previously mentioned, classifying assets as community property potentially exposes the property to the creditors of both spouses. If a spouse has asset protection concerns, a community property trust should be avoided. For example, if you have a client who is in a high-risk profession, such as a doctor, who currently owns all of his or her property as tenants by the entireties with his or her spouse, transferring those assets to a community property trust would result in the couple losing the creditor protection afforded to tenants by the entireties property. If the doctor was thereafter sued, the practitioner who recommended the community property trust would likely need to have an unpleasant conversation with his or her malpractice carrier.

(d) Additional Responsibilities of Advisors. For many of the reasons discussed in this outline, care must be taken when selecting assets to be classified as community property because of the effect on the management and control of the property and disposition of the property at death. Practitioners would also need to advise clients who wish to take advantage of community property trusts regarding the change in ownership, impact on property divisions in the event of divorce, and possible impact on creditor rights. While this adds responsibilities for the advisor and potentially increases the advisor's risk of malpractice, it also increases the chances that a married couple will be harmed by unintended consequences of this type of planning if they are not properly advised. Practitioners who recommend community property trust planning to clients should consider providing a letter to those clients describing the risks and downsides associated with the planning (similar to what some practitioners do when recommending planning which entails a higher level of audit risk, such as GRATs or gifts/sales involving valuation discounts).

5. Will the IRS Respect Florida Community Property Trust Legislation for Purposes of IRC § 1014(b)(6)? In addition to the reasons set forth earlier in this outline, there are two Tax Court cases[60] which seem to strongly support the notion that opt-in community property trust legislation would be effective in transmuting separate property to community property by transferring the property to a community property trust, and to maintaining community property status for assets transferred to such a trust, for purposes of IRC § 1014(b)(6).

These Tax Court cases involved whether the community property laws of Sweden and Germany, respectively, created community property for purposes of the Internal Revenue Code.

[60] See *Westerdahl v. Commissioner*, 82 T.C. 83 (1984); *Angerhofer v. Commissioner*, 87 T.C. 814 (1986).

In these cases, as well as the U.S. Supreme Court case of *Poe v. Seaborn*,[61] the determinative factor of whether the married couple could treat property as community in nature turned on whether each spouse had a vested interest in the property.

In *Westerdahl*, the court reviewed the legislation of the eight original community property jurisdictions and set forth a list of factors to be considered when determining whether each spouse has the required vested interest in property. The court looked to whether the subject community property law (in this case, Sweden's legislation) included the rules that: (1) make the community property liable for the managing spouse's separate torts; (2) prevent the nonmanaging spouse from obligating by contract the community property; (3) require, except in extraordinary circumstances, equal division of the community property upon its partition at divorce; (4) allow the managing spouse to discharge his separate debts from community property; and (5) require the managing spouse to make an accounting of all community property, including wages, when partitioned at the time of divorce. The court then determined whether the Swedish legislation contained any of these factors. As a result of its analysis, the court stated that "[w]e have weighed the presence and absence of the various attributes indicative of community property jurisdictions, and we are of the opinion that the laws of Sweden give a spouse a present vested interest in marital property which matures at the time the property is contributed to the marriage by the other spouse." The court in *Angerhofer* performed a similar analysis in comparing the community property laws of Germany to the community property laws of U.S. states.[62]

The conclusion which can be drawn from these cases is that if a state incorporates characteristics of the community property statutes from the eight original community property jurisdictions in its community property trust legislation, it should be respected by the IRS (or at least by the Tax Court if the IRS challenges a taxpayer's classification of property as community in nature). It appears that this has been done in the Alaska, Tennessee and South Dakota community trust statutes, all of which have not been challenged as of yet by the IRS. The Florida legislation tracked those statutes and incorporated all of the indicia of community property listed in the Tax Court Cases, which should provide some level of confidence that it will withstand scrutiny from the Service.

VI. FLORIDA COMMUNITY PROPERTY TRUST ACT

A. Background. Serious discussions and consideration of adopting community property trust legislation in Florida began in earnest with a presentation at the annual American College of Trust and Estate Counsel ("ACTEC") Florida Fellows meeting in 2017. A subcommittee was formed shortly thereafter through the Estate and Gift Tax Planning ("EGTP") Committee of the Real Property, Probate and Trust Law ("RPPTL") Section of The Florida Bar.

There were extensive discussions at the EGTP Committee level regarding many of the issues discussed in this outline, including the treatment of community property under current

[61] 282 U.S. 101 (1930).

[62] It should be noted that the court discussed Germany's opt-in community property regime, and did not find that this caused a non-recognition of community property status.

Florida law, the IRS' position regarding the recognition of community property status for assets held in stand-alone community property trusts, and whether it would benefit the State of Florida to enact community property trust legislation. The EGTP Committee, chaired by Rob Lancaster of Naples, Florida, voted overwhelmingly in favor of proceeding with drafting Florida community property trusts. From there, the subcommittee reviewed the community property trust statutes from Alaska, Tennessee and South Dakota and spoke with practitioners from those various states about their experiences with community property trusts and the application of their statutes.

It was decided fairly early on that the existing community property trust statutes from other states should be followed as closely as possible since practitioners in those states had not run into any issues with the IRS when claiming the full step-up in basis on the community property trust assets, based on those state statutes. In essence, the subcommittee treated those states' statutes (the Alaska, Tennessee and South Dakota statutes are very analogous) as being a model act. The subcommittee thought that the Tennessee statute was the best-drafted statute out of the three and used that as a starting point. Provisions from South Dakota were also incorporated, and then Florida-specific provisions were drafted and incorporated into the working draft of Florida's community property trust legislation. From those drafting sessions came the Florida version of community property trust legislation – the Florida Community Property Trust Act ("FCPTA").

The FCPTA was discussed in detail at multiple EGTP Committee meetings over the next two years. The EGTP Committee approved the draft of the FCPTA in early 2020, and it was also approved by other RPPTL Committees (such as the Trust Law and Probate Law and Procedure Committees) at subsequent Section meetings. The FCPTA was unanimously approved by the RPPTL Section's Executive Council on August 22, 2020.

The FCPTA was included as part of an omnibus bill which included all of the RPPTL Section's proposed legislation for the 2021 Legislative Session, entitled "Estates and Trusts." The Estates and Trusts bill was sponsored by Senator Lori Berman (SB 1070) and Representative Ben Diamond (HB 609). The bill was unanimously by each legislative committee it was presented to (three on the Senate side and three on the House side). During this process, extensive discussions were had with representatives of the Family Law Section of The Florida Bar. Some changes were made as a result of those productive discussions, which were incorporated into the final version of the bill (together with a small change requested by the Florida Bankers Association). The final version of the FCPTA was unanimously approved, together with the other Section initiatives found in the Estates and Trusts bill, by the Florida Senate.

Governor Ron DeSantis signed the Estates and Trusts bill, including the FCPTA, on June 29, 2021. The bill had an effective date of July 1, 2021 and is now law in the State of Florida.

B. Summary of the Florida Community Property Trust Act. The FCPTA is a new stand-alone part (Part XV) of the Florida Trust Code in Chapter 736.[63]

1. Fla. Stat. § 736.1501. Short title. The opening provision states that the new Part XV of the Florida Trust Code may be cited as the "Community Property Trust Act."

[63] Fla. Stat. §§ 736.1501 to 736.1512

2. Fla. Stat. § 736.1502. Definitions. Section 736.1502 contains seven definitions which are specific to the FCPTA[64] - "community property",[65] "community property trust",[66] "decree," "dissolution",[67] "during marriage", "qualified trustee",[68] and "settlor spouses".

3. Fla. Stat. § 736.1503. Requirements for community property trust. A trust established in Florida will only qualify as a "community property trust" if all of the requirements set forth in Section 736.1503 are met. The requirements to establish a Florida Community Property Trust are as follows:

(a) The trust agreement (all Florida Community Property Trusts must be in writing) expressly declares the trust is a Florida Community Property Trust governed by the FCPTA. This is done to ensure that there are no "accidental" community property trusts and that the settlor spouses are well aware that they are creating (and intend to create) a community property trust.

(b) At least one trustee must be a "qualified trustee" (i.e., a trustee located in Florida). The settlor spouses may serve as co-trustee of the Florida Community Property Trust even if they are located out-of-state, so long as they are serving with a qualified trustee. Presumably, many Florida corporate trustees will begin to offer their services as qualified trustees for these type of trusts (and many will likely agree to serve in a limited administrative capacity, especially in light of the recent passage of the new and improved Uniform Directed Trust Act in Florida).

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[64] These definitions are in addition to the general Florida Trust Code definitions set forth in Fla. Stat. § 736.0103.

[65] The definition of what constitutes "community property" for purposes of the FCPTA includes not only the assets held in the trust, but also the income and appreciation therefrom. The definition was expanded to specifically include income and appreciation from community property trust assets to address the recent ruling in *Philips v. Bremner-Philips*, 477 P.3d 626 (Alaska 2020), which was an Alaska Supreme Court decision finding that the income and appreciation from assets held in an Alaska community property trust were not community property since the Alaska statute did not specifically provide that they were to be treated as such.

[66] Defined as an express trust (so no "accidental" community property trusts) which complies with the requirements of the FCPTA and was created on or after July 1, 2021. It is the author's opinion that an existing joint revocable trust which is amended after July 1, 2021 (in a manner which would result in the trust meeting the requirements of the FCPTA) would be deemed to be created after the effective date for purposes of the Act.

[67] Dissolution means either (1) the termination of the settlor spouses' marriage by divorce, or (2) the entry of a decree of legal separation between the settlor spouses. Eagle-eyed legal scholars, which you all are, will note that Florida does not recognize legal separations of married couples. This, however, was not a mistake on the part of the drafters of the FCPTA – it was included due to the fact that out-of-state couples (who may live in a state which recognizes legal separation) may take advantage of the Florida statute, as will be discussed later on in this outline.

[68] A qualified trustee must be a Florida resident (if an individual) or a bank or trust company authorized to act as a trustee in Florida. This provides the nexus with Florida which will allow out-of-state couples to take advantage of the FCPTA.

(c) The trust agreement must be signed by both spouses. A trust which is signed by only one of the spouses will not qualify as a Florida Community Property Trust under the FCPTA. Additionally, most community property trusts will have testamentary effect, in which case the trust agreement must be executed with the formalities required for the execution of a Will in this state.[69]

(d) The following provision, which is intended to provide clear notice to the married couple establishing the trust of its effect on the trust property, must be contained at the beginning of the 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. ALTHOUGH NOT A REQUIREMENT, IT IS STRONGLY ADVISABLE THAT EACH SPOUSE OBTAIN THEIR OWN SEPARATE LEGAL COUNSEL PRIOR TO THE EXECUTION OF THIS TRUST.

4. Fla. Stat. § 736.1504. Agreement establishing community property trust; amendments and revocation.

(a) This section describes the terms that may be agreed to by settlor spouses in a Florida Community Property Trust. In the trust agreement, the settlor spouses may: (1) determine rights and obligations regarding property in the community property trust; (2) describe the management and control of the trust property; (3) set forth the disposition of trust property upon dissolution, death or other event (subject to Fla. Stat. §§ 736.1507 and 736.1508, which are discussed below); (4) declare whether the trust is revocable or irrevocable; (5) establish any other lawful term of the trust which does not otherwise destroy the community property status of the assets transferred to the trust (this is meant to be a savings clause).

(b) Section 736.1504 provides that the default for a Florida Community Property Trust is that it is revocable. This is different from the Alaska, Tennessee and South Dakota models, which state that the default is that the trust is irrevocable.[70]

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[69] Fla. Stat. § 736.0403(2)(b).

[70] This is likely due to the fact that these are all DAPT states (which Florida is not), meaning that self-settled trusts can be protected from the claims of creditors.

(c) A surviving spouse may amend the terms of a Florida Community Property Trust as to that spouse's one-half interest in the trust, regardless of whether the trust is otherwise irrevocable.

(d) While both settlor spouses are living, they shall be deemed to be the only qualified beneficiaries (within the meaning of Fla. Stat. § 736.0103(16)) of the trust. After the death of a spouse, the surviving spouse is deemed to be the only qualified beneficiary as to that spouse's one-half share of the trust. These provisions apply regardless of whether the trust is revocable or irrevocable. The purpose of these provisions is to ensure that the settlor spouses (or the surviving settlor spouse) are not required to provide annual accountings or other trust information required under Fla. Stat. § 736.0813 during their lifetimes. This is in line with the policy already set forth in Fla. Stat. § 736.0813(4).

5. Fla. Stat. § 736.1505. Classification of property as community property; enforcement; duration; management and control; effect of distributions. Section 736.1505 describes the classification of property transferred to a Florida Community Property Trust – all property held in the trust is community property under the laws of the State of Florida during the marriage of the settlor spouse. The section goes on to specifically provide that if property is distributed from a Florida Community Property Trust, it is no longer community property under the FCPTA. However, the distributed property may retain its character as community property if it was such prior to the contribution to the trust under the laws of a different state or foreign jurisdiction, or under the Florida Uniform Act.[71] This is also the section which provides that there is no requirement that the settlor spouses be domiciled in Florida in order to avail themselves of the FCPTA.

6. Fla. Stat. § 736.1506. Satisfaction of obligations. This section describes creditors' rights against a married couple who have established a Florida Community Property Trust. Protected homestead is specifically excluded from this section. As to non-homestead property held by the trust, (1) an obligation of one settlor spouse (whether incurred before or during the marriage) may only be satisfied from that spouse's one-half of the trust; and (2) an obligation of both settlor spouses (i.e., a joint debt) may be satisfied from any of the trust assets. Not to beat a dead horse, but this is the final reminder that Florida Community Property Trusts should not be recommended to clients who have potential creditor risks.

7. Fla. Stat. § 736.1507. Death of a spouse. Section 736.1507 sets forth the treatment of the surviving spouse's and deceased spouse's respective one-half interests in the Florida Community Property Trust.[72] The surviving spouse's one-half share of the trust is not

[71] By way of example, Husband and Wife move to Florida from Texas and contribute their community property under Texas law to a Florida Community Property Trust. Husband and Wife later decide that trusts are "for the birds" and terminate the Florida Community Property Trust. Once distributed back to the couple, the assets could still qualify as community property since the assets were formerly community property under Texas law (relying on the *Quintana* holding) or, at a minimum, the couple would still have community property "rights" at death because of the application of the Florida Uniform Act.

[72] For reasons previously discussed, in particular the Tax Court rulings in *Westerdahl* and *Angerhofer*, the community property trust assets must be split equally between the settlor spouses at the death of the first spouse.

subject to testamentary disposition by the deceased spouse or under any laws of succession in Florida. The deceased spouse's one-half share of the trust is subject to testamentary disposition by that spouse. The trustee of the Florida Community Property Trust has the power to distribute the trust assets in kind, in divided or undivided interests, or on a pro rata or non-pro rata basis, unless the community property trust agreement provides otherwise (and keeping in mind that the values of the deceased spouse's and surviving spouse's shares must remain equal). This section of the FCPTA also provides that the deceased spouse's one-half of the trust shall not be included in the elective estate. This is consistent with existing Florida law.[73]

8. Fla. Stat. § 736.1508. Dissolution of marriage. This section provides that the Florida Community Property Trust will terminate upon the dissolution of the settlor spouses' marriage,[74] with one-half of the trust assets being distributed to each spouse. It is specifically stated that Fla. Stat. § 61.075, which sets the default standards for distribution of assets in a divorce (i.e., the equitable distribution statute), does not apply to assets held in a Florida Community Property Trust. Similar to the prior section dealing with the distribution of assets at death, Section 736.1508 permits the trustee to distribute the trust assets in kind, in divided or undivided interests, or on a pro rata or non-pro rata basis, unless the community property trust agreement provides otherwise (and keeping in mind that the values of the deceased spouse's and surviving spouse's shares must remain equal). This section, however, goes one-step further and provides that the trustee may not distribute real property or business interests in a manner which would leave the former spouses as co-owners of such assets post-divorce, unless the spouses agreed to such ownership in writing.

9. Fla. Stat. § 736.1509. Right of child to support. Section 736.1509 provides that a Florida Community Property Trust shall not affect the right of a child of either settlor spouse who is required to be provided child support. [75] This section allows for legal attachment against the parental spouse's one-half interest in the community property trust.

Doing otherwise would jeopardize the trust assets' status as community property. This section, as well as Fla. Stat. 736.1508 (dealing with the settlor spouses' rights in the community property trust assets upon divorce), should be viewed as mandatory provisions which cannot be overridden by the trust agreement or by applicable law.

[73] See Fla. Stat. § 732.2045(1)(f), as well as Fla. Stat. § 732.219.

[74] The initiation of an action to dissolve the marriage does not automatically terminate the trust unless the settlor spouses have otherwise agreed or if the court having jurisdiction over the divorce proceedings enters an order terminating the trust. However, if the action to dissolve the marriage remains pending for 180 days, then the trust does automatically terminate, with each spouse receiving one-half of the trust assets, unless (i) a spouse objects to the termination (this would result in a hearing on the proposed termination), (ii) the court enters an order directing otherwise, (iii) the settlor spouses agree otherwise in writing during the divorce proceedings, or (iv) the trust agreement provides otherwise.

[75] By way of example, Husband was previously married and is legally obligated to pay child support for his children from that marriage. Husband remarries and transfers all of his assets to a Florida Community Property Trust. If Husband stops making child support payments, the former spouse (on behalf of the children) could seek payment of the owed child support from Husband's one-half of the community property trust assets. Additionally, Husband cannot claim that income generated by the Community Property Trust should not be taken into account

10. Fla. Stat. § 736.151. Homestead property. Section 736.151 specifies that homestead property transferred to a Florida Community Property Trust retains its homestead character (i.e., the property tax exemption including the Save Our Homes cap[76], the protection from creditors, and the restrictions on devise). The section also specifically provides that property acquired in the name of the trustee of the Florida Community Property Trust may initially qualify as the settlor spouses' homestead, provided that the property would qualify as the settlor spouses' homestead if title was held outside of the trust in one or both of the spouses' individual names. This is a vast improvement over existing Florida law, especially the Florida Uniform Law, which provides that the qualification of a residence as a married couple's homestead immediately terminates the treatment of the proceeds used to purchase the residence as community property.

It should be noted that the FCPTA does not address the issue of restrictions on the devise of homestead property. An earlier draft of the FCPTA provided that the transfer of title to homestead into the name of the community property trust (or the initial application for homestead in the name of the trustee of the community property trust) would be deemed to be a waiver by the settlor spouses of the devise restrictions, but this was removed prior to the approval of the legislation. If the settlor spouses' wish to waive the devise restrictions relating to a surviving spouse's interest in homestead (which they most certainly will if they have entered into this type of planning), they will either need to sign a conditional homestead waiver or ensure that the deed transferring the property to the community property trust contains the safe harbor waiver language found in Fla .Stat. §732.7025[77].

11. Fla. Stat. § 736.1511. Application of Internal Revenue Code; community property classified by another jurisdiction. This section sets out the interpretation and treatment of a Florida Community Property Trust under federal tax law. It specifically provides that the assets in a Florida Community Property Trust are considered community property under Florida law for purposes of establishing the taxable basis under IRC § 1014(b)(6). As previously discussed, § 1014(b)(6) provides for the calculation of the taxable basis in community property of the deceased spouse as of the time of his or her death, and provides for the "double" or "full" step up in basis on community property. Additionally, this section states that community property transferred from another state or jurisdiction retains its character as community property while in the Florida Community Property Trust.

12. Fla. Stat. § 736.1512. Unenforceable trusts. The FCPTA creates Section 736.1512 to make certain Florida Community Property Trusts unenforceable. A Florida Community Property Trust may be found to be unenforceable if: (i) the terms were unconscionable

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for purposes of determining the amount of child support because of the new spouse's interest in the community property.

[76] This section specifically provides that the settlor spouses shall be deemed to have beneficial title in equity to the homestead property for all purposes, including for purposes of Fla. Stat. § 196.031, which should prevent a reassessment of the property and allow for the retention of the Save Our Homes cap and built-up exemption.

[77] "By executing or joining this deed, I intend to waive homestead rights that would otherwise prevent my spouse from devising the homestead property described in this deed to someone other than me."

when made; (ii) the spouse against whom enforcement is sought did not enter into the agreement voluntarily; (iii) the community property trust agreement was the product of fraud, duress, coercion, or overreaching; or (iv) the spouse against whom enforcement is sought did not receive fair and reasonable financial disclosure, did not waive disclosure, and did not have notice of the other spouse's finances. These are in essence the same bases on which a post-nuptial agreement between spouses could be challenged. A Florida Community Property Trust is not unenforceable solely on the basis that the settlor spouses did not have separate and independent legal counsel.

VII. CONCLUSION

There are numerous benefits to having assets classified as community property, primarily the full step-up in basis under IRC § 1014(b)(6) at the death of the spouse first to die. Many residents of Florida move to our state with this type of property (or the proceeds therefrom), whether acquired in one of the nine "pure" community property states or in a foreign jurisdiction (such as Puerto Rico) with a community property regime. For this reason, it is important for all Florida practitioners to be aware of how to identify and plan for this type of property. While there are indications, such as the *Quintana* case and Florida's adoption of a version of the UDCPRDA, that community property will retain its character when brought to Florida, there remains uncertainty as to whether the IRS will contest the status of community property for a Florida decedent for purposes of IRC § 1014(b)(6).

Florida residents should not be deprived of tax benefits afforded to residents of other states. For this reason, and for the other reasons set forth herein, Florida did an admirable job in adopting community property trust legislation, similar to that of Alaska, Tennessee and South Dakota, which will give Florida residents the option of having assets classified as community property and to eliminate uncertainty in this important area of Florida and federal tax law. Florida practitioners should familiarize themselves with the new Florida Community Property Trust Act as soon as possible, and begin to incorporate community property trusts into their estate planning practices.

Florida Community Property Trust
Drafting Tips

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1. Start with your standard joint revocable trust agreement (as you know, a Community Property ("CP") Trust has to be a joint trust between the spouses).

2. Make sure that the trust agreement is explicit that each spouse owns a one-half share in the trust.

3. Include the below provision at the beginning of the trust agreement.

A. Community Property Trust

(1) Intent. We intend for this Trust to be a Florida Community Property Trust within the meaning of Part XV of Chapter 736 of the Florida Statutes. All provisions of this Trust shall be interpreted, construed and administered accordingly Any property added to this Trust by either Settlor while we are both living shall be community property.

INCLUDE IF CLIENTS MOVING FROM CP STATE WITH EXISTING CP:

(2) Prior Residency and Existing Ownership of Community Property. We were formerly residents of the State of Washington, a community property state. We hereby affirm the community property character of any assets held by or added to this Trust which were acquired by either of us, during our marriage, while we were residents of the State of Washington, and which then constituted community property. The execution, funding and/or administration of this Trust shall not alter the character of any such community property held in this Trust. Any income earned or accrued by this Trust shall have the same character as the property to which such income relates, whether or not such income is later added to trust principal. Any property distributed from this Trust while we are both living shall have the same character as such property had prior to its addition to this Trust. The Trustees may rely upon any certification made by either of us as to the community property character of any property held by or added to this Trust.

(3) Notice to Settlors. We both acknowledge that we have discussed the implications of entering into this Florida Community Property Trust with each other and with legal counsel, and we have read and understand the following notice relating to the Trust:

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. ALTHOUGH NOT A REQUIREMENT, IT IS STRONGLY ADVISABLE THAT EACH SPOUSE OBTAIN THEIR OWN SEPARATE LEGAL COUNSEL PRIOR TO THE EXECUTION OF THIS TRUST.

4. The CP Trust Act specifically allows for homestead property to be held in a CP Trust. This provision should be included to ensure that homestead may be held in the CP Trust:

> **Homestead Rights.** Despite any other provision of this Trust, we reserve the right to reside on any real property owned by the Trust during our lifetimes or the lifetime of the survivor. We (or the survivor of us) will be entitled to claim any available homestead tax exemption for any real property in the Trust pursuant to Section 736.151 of the Florida Statutes and other applicable Florida law, and, for purposes of that exemption, our interest in such property will be deemed an interest in real property and not an interest in personal property. This provision does not restrict the Trustee from selling, leasing, or encumbering that property without our joinder in any deed or other instrument.

5. Include the following in your article dealing with the administration of the trust during the couple's lifetimes:

> **Settlors' Shares**. While both of us are alive, each of our shares in the Trust Estate is to be augmented by one-half of all income, gains, and receipts, and reduced by one-half of all proper expenses and charges, plus any specific distributions or withdrawals attributable to our respective shares. Distributions to a Settlor and withdrawals by a Settlor are to be charged to the share of that Settlor, unless the instructions for distribution or withdrawal state to the contrary and are authorized in writing by both Settlors. All assets held under this Trust are to be administered as one fund, although separate accounts are to be maintained for the respective share of each of us, which may include undivided interests in the same assets. Notwithstanding the foregoing, the shares in the Trust Estate shall not be administered at any time in a manner which is not in accordance with Part XV of Chapter 736 of the Florida Statutes.

6. Include the following provision in your trustee provisions:

> At all times that this Trust is a Florida Community Property Trust, at least one Qualified Trustee, as defined in Section 736.1502(6) of the Florida Statutes, shall be required to serve as a Trustee of this Trust at all times. If at any time a Qualified Trustee is required and one is not then serving, the persons then entitled to appoint

successor Trustees shall immediately appoint one or more Qualified Trustees for this Trust.

7. Include the below provision somewhere in your trust agreement. Keep in mind that there has to be a 50/50 split of the CP Trust assets upon divorce and at death.

Divorce of Spouses. In the event of the dissolution of the Settlors' marriage, this Trust shall terminate and the Trust assets shall be distributed in accordance with Section 736.1508 of the Florida Statutes.

8. Include the following in the "Definitions" section of the trust agreement:

All of the property and the appreciation of and income from the property held in this Trust shall be **community property** within the meaning of Part XV of Chapter 736 of the Florida Statutes and for purposes of the application of Section 1014(b)(6) of the Internal Revenue Code.