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*FLORIDA HOMESTEAD*

## **New Florida Homestead Laws Add Flexibility in Estate Planning**

*Recent revisions in the Florida homestead rules create new planning opportunities for credit shelter trusts, dynastic trusts, and those with special-needs beneficiaries.*

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The ever-changing “legal chameleon” known as Florida homestead has changed colors again—this time to benefit those who wish to plan with their homesteads. Estate planners who have clients currently living in Florida or represent clients who are planning to move there need to be aware of the Florida homestead laws and these new developments. This includes the potential malpractice traps for those who tread into homestead territory, as well as the several advantageous changes for homestead planning.

Toward the end of its 2010 session, the Florida legislature passed new and important homestead laws affecting planning in a positive manner.<sup>1</sup> The laws took effect on 10/1/2010.

As most readers are already aware, Florida homestead laws are unique among similar laws of other states, and are arcane and confusing even to Florida lawyers. They present significant malpractice traps for unwary practitioners who draft documents for clients living in or moving to Florida.

Florida's unique set of homestead laws have thwarted many well-intended (and well-drafted) estate plans. Too often, estate plans with credit shelter trusts and generation-skipping trusts fail to achieve their purposes due to the inability to fund these devises with Florida homestead property. Undoubtedly, the homestead devise restrictions, which emanate generally from Florida's Constitution, will continue to frustrate many plans in the future. For those practitioners who focus on homestead planning issues (and those clients working with planners who do), new tools are available to plan with Florida homesteads.

### **Background**

Florida Homestead laws are generally segregated into three categories. The first two categories are beyond the scope of this article, but they are worth noting.

(1) Probably most famously, Florida law protects an owner of a homestead from the claims of creditors, regardless of the value of the homestead.<sup>2</sup>

(2) Florida provides ad valorem property tax benefits to an owner of a homestead, including a 3% cap on the annual increase in the assessed value of the homestead. This tax benefit was vitally important for many clients, especially when real estate values were showing double digit annual increases in value.

(3) Of greatest relevance for purposes of this article, Florida law restricts the ability of a homestead owner to devise the homestead if survived by a spouse or minor children, and it also imposes certain restrictions on lifetime alienation.

In pertinent part, the Florida Constitution in Article X, section 4(c) provides:

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

The constitutional provisions are adopted in Florida Statutes (FS) 732.4015, which provides:

732.4015 Devise of homestead.—

(1) As provided by the Florida Constitution, the homestead shall not be subject to devise if the owner is survived by a spouse or a minor child or minor children, except that the homestead may be devised to the owner's spouse if there is no minor child or minor children.

(2) For the purposes of subsection (1), the term:

(a) "Owner" includes the grantor of a trust described in s. 733.707(3) that is evidenced by a written instrument which is in existence at the time of the grantor's death as if the interest held in trust was owned by the grantor.

(b) "Devise" includes a disposition by trust of that portion of the trust estate which, if titled in the name of the grantor of the trust, would be the grantor's homestead.

(3) If an interest in homestead has been devised to the surviving spouse as authorized by law and the constitution, and the surviving spouse's interest is disclaimed, the disclaimed interest shall pass in accordance with chapter 739.<sup>3</sup>

As the reader can see, the constitutional restriction on devise and its statutory counterpart make post-death planning as well as certain lifetime planning with homestead property particularly tricky. Several of the difficult planning situations include:

- (1) The desire to use part or the entire homestead to fund a credit shelter trust.
- (2) The desire to leave assets in trusts for minors as opposed to outright.

- (3) The ability to implement "special needs trust" planning.
- (4) Implementing qualified personal residence trust planning.
- (5) Medicaid planning.

While the Florida Constitution says that a homestead "shall not be subject to devise" in certain circumstances, it does not say what happens when a homestead is impermissibly devised. Instead, the consequences of impermissible devises are fleshed out by statute. FS 732.401 provides:

732.401 Descent of homestead.—

(1) If not devised as permitted by law and the Florida Constitution, the homestead shall descend in the same manner as other intestate property; but if the decedent is survived by a spouse and one or more descendants, the surviving spouse shall take a life estate in the homestead, with a vested remainder to the descendants in being at the time of the decedent's death per stirpes.

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(5) This section does not apply to property that the decedent owned in tenancy by the entireties or joint tenancy with rights of survivorship. <sup>4</sup>

## Planning options before statutory changes

Taking the statutes and the constitution together, the homestead devise restriction rules and the imposition of a life estate/remainder have forcibly and unwittingly altered many estate plans. While the life estate may be "QTIPed" or not (as the executor may elect), <sup>5</sup> the inability to devise the homestead into a trust controlled by the surviving spouse can create unwanted and undesired consequences. Prior to the recent legislative changes, the options for planning were fairly limited and oftentimes quite unexpected and unpleasant.

Florida case law has previously held that a valid nuptial agreement will avoid the constitutional limitations on devise if there are no minor children. <sup>6</sup> For this reason, the primary advice to clients hoping to use the homestead to fund a credit shelter trust (and still the ongoing advice in some situations) is to execute a postnuptial agreement waiving homestead rights. Even when explained in the context of tax planning, approaching any client (or having the client approach a spouse) about a postnuptial agreement—and then walking the clients through the statutory requirements of full financial disclosure and separate counsel—creates significant heartaches and headaches for the planner and client alike.

## Planning Tip

Some practitioners assert that preparing a postnuptial homestead waiver can be accomplished via a "simple" agreement without separate representation and without formal financial disclosure. However, due to the risk of a subsequent change of heart and potential malpractice suit or bar complaint, the prudent tactic is to insist on all the formalities of a formal postnuptial agreement, including separate representation to avoid any issue of conflict of interest. In that case, a "waiver of conflict letter" is also necessary in order for the planner to continue to represent the clients jointly in their estate planning. Further, in order to satisfy FS 732.702, a financial disclosure is required. All in all, postnuptial agreements present a fairly unattractive process.

A second option for those desiring to use a homestead to fund a credit shelter trust relies on a post-death disclaimer. By statute, if a homestead is owned as tenants by the entirety and then disclaimed by the surviving spouse, the one-half disclaimed should not become subject to the homestead devise restrictions, and thus should be eligible to flow into the credit shelter trust after a timely disclaimer.<sup>7</sup> In this regard, FS 739.203(4) states:

A disclaimer of an interest in real property held as tenants by the entirety does not cause the disclaimed interest to be homestead property for purposes of descent and distribution under ss. 732.301 and 732.4015.

While the ability to title a homestead as tenants by the entirety and disclaim half provides a planning choice, of course, such planning allows only half the homestead to be used in funding a credit shelter trust, and it relies on the surviving spouse to disclaim after the death of the first spouse.

A third option also relied on a disclaimer, followed by a devise to the credit shelter trust. By way of example, a wife might own the homestead in her name alone and if there was no minor child, she might devise the homestead in her will outright to her husband; the will could then provide that if the spouse executed a disclaimer of the homestead devise, it would pass to the credit shelter trust. Unfortunately, due to a split of decisions in the Florida Circuit courts, there was uncertainty as to the viability of this option.<sup>8</sup>

For both the second and third options, above, relying on disclaimers has its own risks—including (a) the risk the spouse will not or cannot disclaim and (b) the risks attendant with not having a power of appointment over the disclaimed assets. Moreover, these options dealt with only possibly funding a credit shelter trust and did not offer any solutions for minor children or special needs trust planning.

## **Statutory changes offer opportunities and clarification**

As a result of the new statutes, for clients thinking of the issues and wishing to plan ahead with their homesteads, new homestead planning options are available, and some of the existing planning options have become more certain.

**Disclaimers.** The first helpful changes involve disclaimer planning. Two new statutory changes add clarity to such planning.

FS 732.4015(3) has been adopted clarifying that if a homestead is validly devised (i.e., a client with no minor children provides a devise of the homestead to the spouse outright), then a disclaimer of the devise by the spouse does not cause the devise restrictions to come into play. Instead, the disclaimed homestead passes the same as other disclaimed property—i.e., to the takers in default.

As a result, it is now clear by statute that the disclaimer funding of a credit shelter trust, discussed above, should work. For example, applying the example above, a client with no minor children may include a specific devise of the homestead to the spouse with a direction that if the spouse disclaims it, the homestead passes to the credit shelter trust. While many believed such planning worked before, now for clients with faith in the surviving spouse to disclaim the outright devise, there should be clarity that such planning is effective.

This planning technique is available, however, only where all of the children are adults, and it is quite risky (and likely not viable) in cases where the spouse is not also the parent of the adult children. Thus it is not likely to be used in cases of second or subsequent marriages where there are children from prior marriages. Moreover, the inability to control the homestead in the credit shelter trust by a power of appointment may still lead some clients to prefer alternative planning options such as nuptial agreements.

Similarly, new subsection (4) in FS 732.401 provides that if a homestead is invalidly devised (i.e., a husband leaves the homestead to one of his three children, but he has a surviving spouse), a disclaimer by the spouse will not "fix" the invalid devise. The issue relates to the intersection of two theories or fictions applying simultaneously. On the one hand, in the case of an invalidly devised homestead, title vests as a life estate/remainder as of the moment of death under the theory that title is never held in abeyance, and the life estate/remainder interests are created immediately. On the other hand, the legal fiction of disclaimers is to treat the disclaimant as predeceasing; thus the rights of the parties should apply as if the disclaimant were not alive on the moment of death. These two theories compete in result in the context of a disclaimer of the spousal interest in invalidly devised homestead.

The new statute clarifies that the spouse's disclaimer (although theoretically also effective as of the moment of death) will not breathe life back into an invalidly devised homestead. In other words, as a result of the invalid devise, the interests of the remainder beneficiaries vest at the moment of death and cannot be divested by the disclaimer. Some commentators refer to this as "taking a snapshot" at the moment of death.

Some practitioners preferred that disclaimers by spouses could "fix" invalid devises, but the majority of the bar preferred a rule that the legal fiction of the immediate vesting of the homestead interests trumped the legal fiction of a disclaimer's retroactive application to the moment of death. While that provision was controversial, at least now there is certainty in the law.

**New statute on transfers to irrevocable trusts.** New FS 732.4017 (which states it is codifying existing law) permits transfers of homesteads to irrevocable trusts without post-death devise restrictions, even if the client retained certain interests (e.g., a retained life estate, a reversion, a possibility of reverter [when the minor child turns 18, for example] or even a fractional fee interest), without invoking the homestead devise restrictions. This irrevocable trust planning will help some clients with credit shelter trust planning, particularly if the client does not want to approach his or her spouse about a postnuptial agreement and does not want to rely on a disclaimer (as in many second marriages), and will help others who want to use trust vehicles for beneficiaries (e.g., those with minors and those with special needs beneficiaries).

Of course, such lifetime alienation to an irrevocable trust will still require the joinder of the spouse in the deed as required by Article X, section 4(c) of the Florida Constitution. Interestingly, Florida law is not quite settled on the issue of whether the spouse needs to join in the deed if a nuptial agreement exists. The "safe" course is to require the spouse to join in the deed, even if there is a nuptial, and then there will not be an issue. If the spouse does not join, there may be a title problem. The Fund Title Notes directly address this point and assert that even though FS 732.702 and FS 61.079 authorize waivers of homestead rights by nuptial agreement, the statutes cannot prevail over the constitutional requirement of spousal joinder in an alienation of the homestead property, and the spouse must still join in the alienation (deed) before a Fund title policy could be issued in such a transaction.<sup>2</sup> Contrast, however, *In re Guardianship Tanner*,<sup>10</sup> from Florida's Third District Court of Appeal (involving a case in Miami-Dade county). That case

held that as a result of a valid postnuptial agreement in which a spouse waives his right to claim a homestead interest, the spouse in effect released or alienated his homestead rights. As a result, the spouse's refusal to join in a conveyance of the other spouse's homestead property cannot affect an otherwise proper alienation (in this case a sale) of said homestead property.

The new homestead statutes now make clear that the creator of an irrevocable trust funded with a homestead may retain important rights over the property and the trust without it becoming devise restricted at death, so long as the client does not retain a right to revoke or revest. For example, the statute provides that if the grantor retained a right to alter the trust beneficiaries during lifetime (i.e., a lifetime limited power of appointment to avoid a completed gift), the right will not be deemed a power of revocation or a power to revest so long as it cannot be exercised in favor of the grantor, the grantor's creditors, the grantor's estate, or the creditors of the grantor's estate (i.e., so long as it is not a general power of appointment).

Admittedly, this type of planning is likely accessible primarily for wealthy clients. Creating highly specialized irrevocable trusts and very technical life estate deeds will not be a good fit (or necessarily affordable) for everyone. Moreover, if the property is encumbered by a mortgage, this planning carries an added cost, as the Florida documentary stamp taxes (\$7,000 per \$1 million of value—in this case based on the value of the mortgage at the time of the transfer) make such transfers unattractive. While reasoned arguments have been made as to why such trust transfers ought not be subject to documentary stamp taxes (or should not be on the full value of the mortgage), it is the author's understanding from discussions directly with representatives of the Department of Revenue (DOR) that the DOR's position is that documentary stamp taxes will be due on such transactions.

Nevertheless, this new statute confirms homestead planning opportunities for certain clients, and may be the only way to plan for clients with minors and special needs beneficiaries.

**Developments regarding QPRTs.** For clients funding homesteads into QPRTs (or those with QPRTs who later move in and make that home their homestead), the law clarifies that the retained reversion—which the client, of course, wants to include in the QPRT for gift tax purposes—will not cause the homestead to be devise restricted if the client dies during the QPRT term. New FS 732.4017 provides in pertinent part that if the owner of homestead property transfers the property to an irrevocable trust, “the transfer is not a devise for purposes of s. 731.201(10) or s. 732.4015” if the grantor fails to retain a power to revoke or revest the property in the grantor. Moreover, the statute clarifies that the homestead devise restrictions will not apply even if there is a retained term of years and reversion—as is the case with a typical QPRT.

As a result, the use of homesteads to fund QPRTs has been clarified, and the inclusion of a reversion (for gift tax purposes) will not cause the homestead devise restrictions to apply, even if the grantor dies during the term.

The new statute specifically says that it “is the intent of the Legislature that this section clarifies existing law.” As such, for clients with existing QPRTs funded with homesteads, these “new” rules also apply.

**New tenant-in-common election.** Finally, there was one other major change to the probate laws regarding homesteads that may affect estate planners. While this new provision is a probate election, it will affect planning for certain clients. For estates of

decedents dying after October 1, if a homestead is invalidly devised, new FS 732.401(2) provides for an election by the surviving spouse to take a one-half interest as tenant in common instead of the life estate otherwise provided.

This new statute may affect existing plans in unanticipated ways. There are multiple reasons why a spouse may prefer this new tenant-in-common option,<sup>11</sup> and it is important for planners to know the option now exists, and to consider how the option affects their estate planning.

For example, clients who relied on the restrictions of FS 732.401 to keep their homesteads in their bloodlines, may now need to use nuptial agreements or irrevocable trusts to ensure such protection. Indeed some clients may have relied on the life estate/remainder relationship created by FS 732.401 as part of their blood-line planning; however, due to the new statute, if the survivor makes the election, one-half of the homestead may pass outside the family. Thus, many clients may need to revisit their plans in light of the new election.

As another example, a surviving spouse may now elect the tenant-in-common interest and create an estate tax where a tax may not have otherwise existed. Such previously unexpected estate tax consequences after the first spouse's death should now be taken into consideration.

In the past, the personal representative might have "QTIPed" the homestead life estate and deferred estate taxes until the second spouse's death. Now, if the spouse elects to take a one-half tenant-in-common interest, of course, the other half will not be eligible for a marital deduction.

Thus, the new probate election may not only affect the probate of estates, but it also may have a profound effect on lifetime planning for homesteads.

## Conclusion

Recent developments and changes in Florida's homestead laws offer new and exciting (or scary—depending on one's perspective) planning opportunities. For clients with Florida homesteads, the changes open up new avenues for credit shelter trust planning, planning for dynastic trusts for descendants, and planning for beneficiaries with special needs.

However, given the many technical aspects to the statutes and the many potential pitfalls of homestead planning (posed by the various homestead traps for the unwary), it is still a highly specialized area and one requiring very particular attention in both planning and administration.

<sup>1</sup>

<sup>2</sup> The homestead law changes were all passed as part of House Bill 1237 (HB 1237).

<sup>3</sup> The unlimited Florida homestead exemption from creditor's claims is preempted by federal law and limited in the bankruptcy context to an aggregate of \$125,000 (with certain exceptions and limitations) if the homestead was acquired by the debtor within 1215 days of filing the bankruptcy petition.

<sup>4</sup> Subsection (3) of FS 732.4015 was added to the statute as part of HB 1237.

<sup>5</sup> Subsection (5) of FS 732.401 was modified as part of HB 1237.

<sup>6</sup> Florida's homestead life estate can qualify as "qualified terminable interest property" or "QTIP" under [Section 2056\(b\)\(7\)\(B\)\(ii\)](#); see also [Reg. 20.2056\(b\)-7\(h\), Example 1](#).

<sup>7</sup> City National Bank of Florida v. Tescher, 578 So 2d 701 (Fla., 1991).

<sup>8</sup> Some commentators have argued that this statutory interpretation is unconstitutional as the statutes cannot change the constitutional meaning—only interpret it. However, there appears to be a logical argument (sufficient to pass the Florida legislature) that the determination of the consequences of a post-death act like a disclaimer on a tenancy by the entirety property should not create a devise-restricted homestead.

<sup>9</sup> See In Re: Estate of Ryerson, Jr., 642 So. 2d 763 (Fla. 4th DCA, 1994); In Re: Estate of Sudakoff, 681 So. 2d 1146 (Fla. 2d DCA, 1995); and Janien v. Janien, 939 So 2d 264 (Fla. App., 2006).

<sup>10</sup> The Fund Title Note 16.04.14.

<sup>11</sup> 564 So 2d 180 (Fla App 3 Dist, 1990).

For example, payment of the interest on a mortgage is a life tenant's obligation, in addition to real estate taxes, insurance, and ordinary maintenance and repairs. If the property has a large mortgage, the mortgage interest may exceed the use value of the home. In this case, the election to take a tenant-in-common interest becomes very appealing.

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