OFTEN OVERLOOKED ESTATE PLANNING ISSUES

BY

JEFFREY A. BASKIES
KATZ BASKIES LLC
WWW.KATZBASKIES.COM
JEFF.BASKIES@KATZBASKIES.COM

I. Overuse/Underuse of Credit Shelter Trusts ("CSTs") vs Portability

A. Some advisors are almost never using CSTs – but:

1. Portability is not indexed for inflation; whereas, the assets in a CST can appreciate tax free.

2. GST exemption is not portable and failure to maximize clients' GST exemption could have huge adverse consequences for future generations.

3. Portability requires filing a form 706 even in non-taxable estates – CSTs do not.

4. Portability doesn't allow for sprinkling distributions to children or grandchildren, which might lower overall income taxes and meet a surviving spouse's gifting plans.

5. State-level estate taxes may be an issue if clients use portability instead of a CST.

6. Portability isn't available if the decedent or spouse is a nonresident noncitizen because 2102(b)(1) doesn't have a DSUE amount…Portability is available potentially for a citizen decedent with a noncitizen spouse using a QDOT, but the application of the rules gets extra complicated, since the surviving spouse can't get/use the DSUE until the QDOT is disposed of and the unused exemption of the deceased spouse is known (typically not until the survivor's death).

B. Some advisors are almost always using CSTs – but:

1. Using CSTs means added costs of administration – accounting issues, tax returns, etc.

2. Some clients are frustrated with having to account to children or descendants.

3. There are potentially higher income taxes if income is accumulated in the trust vs distributed.

4. **There's a loss of step-up in basis on the 2nd death for assets in the CST.**

C. To mitigate the loss of step-up in basis on the 2nd death, some advisors are drafting or suggesting adding in "springing" general powers of appointment into CSTs and/or appointing a protector and giving the protector the right to create a general power of appointment for cost basis purposes.

1. One problem is how to define when to create the general power. Another is to define how broad or limited the general power should be.

2. Is getting a stepped up basis worth losing/wasting GST exemption?

3. Should you limit the general power to creditors of the estate of the surviving spouse?

4. Can you give the general power only over assets that have appreciated in the CST?

5. Should there be a cap so that the general power doesn't create estate tax in the survivor's estate?

6. Should there be an ordering provision so that the general power applies first to assets having the most gain? Or to depreciable assets first (so you get a step-up in basis plus a higher depreciation base for income tax purposes too)? Or should you direct the power over creator owned IP assets (converting ordinary income assets to cap gains)? Or negative basis assets (commercial real estate LPs)? How about collectibles like artwork or gold (28% tax)?

7. What about consideration for the state estate tax consequences of creating this general power?

II. Reciprocal Trust Doctrine

A. Particularly in 2012, but in many other instances, it appears clients are creating trusts that may violate the reciprocal trust doctrine.

B. A classic example:

1. Husband creates a "SLAT" for wife and kids with sprinkling income and principal and no power of appointment and funds it with about $5mill of assets (perhaps of a FLP).

2. At the same time, or soon thereafter, Wife creates a "SLAT" for husband and kids with sprinkling (or maybe mandatory) payments and a limited power of appointment and funds with about $5 mill of assets (perhaps of a FLP) – although some advisors might suggest the two trusts be funded with slightly different amounts or assets.

3. Advisor recommended this plan and specifically told clients that to avoid the reciprocal trust doctrine, the trusts should be funded a few weeks apart and one trust should have a power of appointment but the other shouldn't…..this recommendation is maybe even put in writing.

4. Assume the trust terms/powers would create estate inclusion if the beneficiary of the trust had been the settlor of the trust; i.e. if the Reciprocal Trust doctrine applies.

5. If it applied, the Reciprocal Trust doctrine would uncross the trusts at the level of the settlors, treating the beneficiary/powerholder as the settlor of the trust in which their beneficial interests/powers are granted.

6. Many advisors rely on *Estate of Levy v. Commissioner,* 46 TCM 910 (1983) (more below) and believe the trusts are non-reciprocal and "safe".

7. But see *Estate of Grace v. US,* 395 US 316 (1969) (more below) focused on "interrelated" trusts and economic effects.

C. Estate of Grace v. US, 395 US 316 (1969)

1. The court said it did not have to delve into the subjective intent of the parties in creating the trusts; instead, the Court said it

would apply the reciprocal trust doctrine when it finds there's been a quid pro quo.

2. "(A)pplication of the reciprocal trust doctrine requires only that the trusts be interrelated, and that the arrangement, to the extent of mutual value, leaves the settlors in approximately the same economic position as they would have been in had they created trusts naming themselves as life beneficiaries."

3. In *Grace*, the trusts were created 15 days apart, and that was deemed sufficiently close in time to be interrelated.

4. "Mutual value" has been inappropriately used as a "sword" by some advisors who have said that by funding the trusts with different amounts, the reciprocal trust doctrine shouldn't apply. That advice is WRONG. See Rev. Rul. 74-533 and Rev. Rul. 57-422.

    a) Assume husband funded SLAT with $5mill and wife funded SLAT with $4mill. That doesn't avoid the reciprocal trust doctrine.

    b) Instead, the mutuality of value doctrine, will cause $4mill of each trust to be uncrossed at the settlor level (so 100% of the wife's and 80% of the husband's trusts would be uncrossed and treated as the other/beneficiary spouse funded it).

D. How to avoid the Reciprocal Trust Doctrine – avoiding *Grace*

1. The key element is that the trusts not be interrelated.

2. They should not be created at substantially the same time and they should not have substantially the same economic effect on the settlors.

3. Ideally the trusts should not be from the same plan and should not have the same genesis. The advisor's memo may now come back to hurt the client. There's no bright line test for inter relatedness. The margins of the reciprocal trust doctrine are not clear.

4. Minor changes like in trusteeship or terms (especially changes in the terms for beneficiaries other than the settlors) are not

going to avoid the interrelatedness test or the economic effect test.

E. Do powers of Appointment get us out of the Reciprocal Trust Doctrine – *e/o Levy*?

1. For years, some advisors have suggested that we may rely on the only other frequently cited case about the reciprocal trust doctrine – the *Estate of Levy v. Commissioner*, 46 TCM 910 (1983).

2. In *Levy*, spouses created trusts for each other which were essentially identical except in one trust there was a limited power of appointment the spouse could exercise while the other trust had no power.

3. PLR 200426008 accepted the *Levy* holding for the proposition that one trust not having a power of appointment caused two trusts not to be reciprocal.

4. We all know PLRs can't be relied on and are not citable as precedent.

5. But only some know that *Levy* can't be relied on and is not citable as precedent. It is not citable or precedential because (i) it is a Tax Court Memorandum opinion (which like a PLR is not precedential) and (ii) because the reciprocal trust doctrine issue in the *Levy* case was stipulated. The court was not asked to rule that the power of appointment in one trust kept the doctrine from applying. Instead, the government stipulated that if the court deemed the limited power of appointment valid under NJ law, then the two trusts won't be treated as interrelated.

   Thus, the *Levy* court ruled without ever reaching the merits of whether the limited power in one trust was a sufficient difference to preclude the reciprocal trust doctrine's application. As a result, one can't rely on or cite *Levy*, and it is fair to say that no one really knows how much different the trusts must be.

III. Charitable Planning

A. Private Foundations may be Over-used and may have Issues*:*

1. For example, we fairly often see the situation where a client who has no immediate family is leaving the entire estate to a foundation to be run by a distant cousin, financial advisor and/or accountant – maybe the drafting attorney gets added into the mix/board too.

2. How often have you seen clients with a relatively small private foundation annually pay salaries to Husband, Wife and adult kids? Now they are trying to set up pension plans.

3. A philanthropist wants to educate children on the financial markets and investing. That's a reasonably good idea and something not taught in school. But he mostly educates children and grandchildren of friends, family and neighbors in his country club. Next, he wants to give each child $10,000 to invest in the stock market. He wants to do it via his foundation. One of the recipients of a proposed grant is the child of a board member, others are the children of the client's lawyer and accountant.

4. In multiple marriage families should the patriarch favor one foundation or multiple foundations? There are big issues for a wealthy client with mixed marriage-children planning to fund a single large foundation post-death:

a) Put new spouse and old spouse potentially at odds;

b) Put step-siblings potentially at odds;

c) By the time the problems bubble up to the surface, it may be too late and/or too hard to fix them as the family rift may have already developed;

d) Consider if each family might be better off with a separate foundation;

e) But would 2 foundations lose some of the synergy benefits, the economies of scale in management, the efficiencies of one set of books, records, investments, etc?

B. Charitable Lead Trusts are Under-used

1. Lifetime CLTs are very powerful in a low interest rate environment. They may facilitate large-scale philanthropy and wealth transfer.

a) Consider the term – term of years vs. life. Don't forget to consider CLTs based on the life expectancy of a family member with impaired life expectancy (ghoulish but still viable).

b) Consider the beneficiary/charity. Don't forget if the beneficiary is the family foundation, the grantor must be walled off from the CLT funds to have a completed gift.

c) In low interest rate environments "zero-gift" or very low gift CLTs are attractive.

d) Consider opportunities to fund with discounted assets that produce cash flow to fund payments.

e) Consider increasing payout CLTs

f) Consider "shark-fin" CLTs.

g) Clients need to consider grantor vs. non-grantor CLTs and the up-front income tax deduction vs annual income taxation of grantor trust treatment.

2. Testamentary CLTs are useful in many estate plans, and many advisors are not looking for these opportunities.

a) Set a cap on the estate tax ($0 tax plan – or maximum tax plan). Shift everything over $x to charity (maybe a foundation), via a CLT (with a potential remainder).

b) Tax-capped estates with CLTs reduce IRS audit incentive and might be beneficial in estates with closely held businesses and discountable assets.

c) Consider using a “Frozen T-clat” – Neslon and Tescher article. Big benefits compared to standard testamentary CLT plans:

(i) Family benfits from excess investment performance before CLT ends; and

(ii) Avoids/minimizes/reduces private foundation rules and penalties - Sec 4941 (self-dealing) and Sec 4943 (excess business holdings).

(iii) To qualify for the exception contained in T. Reg 53.4941(d)-1(b)(3), to avoid an indirect act of self-dealing, a sale of the family business or FLP interests must be made during the estate administration, must be at full fair market value and must be approved by the probate court. An option in a dynasty trust to buy the assets at FMV is a recommended technique.

C. Time to contact clients with charitable bequests?

1. This may be overlooked, but since the estate tax exemption went up, charitable bequests have no tax benefits to many clients. These clients should consider if giving the assets to their children, for example, with a nonbinding instruction for the children to donate the funds would better meet their goals as it will afford a tax benefit to someone. Of course, there is an element of trust that some clients may not have, but this concept should perhaps be explored at least**.**

2. But don’t forget, charitable giving is more than just taxes, and some clients will still want to keep bequests.

D. Using CRTs to avoid the Obama/Medicare 3.8% Surtax

1. Some advisors are suggesting opportunities for clients to avoid the 3.8% surtax. One way is to be actively involved in a business, for example.

2. Another option is to fund a CRT. CRTs are exempt from the 3.8% surtax under section 1411. For example, a

client owning highly appreciated assets she plans to sell, may instead fund the assets into a CRT and then have the CRT sell. She will avoid income tax in the year of sale as well as the 3.8% surtax. The income tax (or most of it) will likely come back to the client over time as the trust distributions are made, but the surtax may be avoided, if the income thresholds for the grantor are not met – perhaps avoiding the surtax forever.

3. Eligible charities to be remainder beneficiaries of the CRTs are the client's private foundation, a donor advised fund at a community foundation, or public charities.

E. Tax Apportionment.

Whenever you use a testamentary charitable plan, be sure to review the tax apportionment language and consider the circular calculation caused by apportioning against the charitable bequest.

IV. Drafting Discretionary Clauses

A. Many planners have not taken a closer look at their standard trust distribution provisions in eons. We frequently hear that the trusts planners are drafting are not understood by the clients or they don't reflect what the clients want. We also frequently hear that trustees are looking for more guidance and more direction on how to administer the trusts we are preparing.

B. There are many issues for consideration in our standard trust distribution clause in our forms and in unique drafting for clients:

1. Ascertainable standards are not always well drafted. This is not a time to get creative. Use the words in Sec 2041 of the code: health, education, maintenance and support. Comfort, welfare and general terms are generally best avoided. There's plenty of room in the standard terms from the Code.

2. Absolute discretion may be stated as full and absolute or may be stated in relation to the best interests of the beneficiaries. Based on a trustee's fiduciary duties, any distributions in absolute discretion are still subject to the trustee reasonably concluding it's in the best interests of the beneficiary.

3. Consider a hybrid – "as trustee, in absolute discretion, deems to be in the best interests of beneficiary".

4. In a single trust, there may be different standards for different trustees. An independent trustee may be given an absolute discretion standard or best interests standard, if serving. A non-independent trustee may be given an ascertainable standard.

5. Must or should other resources be taken into account? What if the beneficiary intentionally squanders or gifts away all of her assets and now wants invasions of a trust?

6. Should distributions relate to a beneficiary's "accustomed standard of living"? That's a term we

frequently see, but:

a) What standard of living does that mean?

b) For a spouse, does that mean the standard to which she was accustomed before the marriage to the wealthy husband, or the standard during the marriage? Does it matter how long the marriage was? Or does it matter, that the husband's earnings substantiated the standard of living and his death doesn't leave enough assets to support such a standard without dissipating or perhaps exhausting the trust principal? What's the trustee supposed to do then? Use principal to prop up the standard of living to one the trust can't afford and likely dissipate the entire principal?

c) What's the standard of living a trustee should consider when looking at a minor child at the time of the death of a trust grantor? The standard of living of the average 10 year old is staying in mom and dad's house and having life paid for! Is that the standard a trust should provide for the beneficiary for life? What about private yachts and planes mom and dad paid for during life? Minors obviously don't own homes, or invest in businesses or professional practices, so does maintaining a standard of living to which the minor was accustomed at the time of grantor's death preclude future principal distributions for such issues?

7. Are a beneficiary's taxes something the client would want the trustee to pay?

8. Consider drafting prioritization provisions in trusts with multiple permissible beneficiaries. For example, in a trust for child and descendants, perhaps say: "during the life of my child, the interests of my child should be considered paramount and preferred over the interests of any potential remainder beneficiaries."

9. Beware of incentive clauses. They typically exacerbate issues. Typically they don't pay out to the beneficiaries who need help the most (e.g. a beneficiary who is earning

less while helping the poor or educating children), and they pay out the most to the beneficiaries who need it the least. For example, a dollar for dollar invasion of principal for a beneficiary already earning $2 mill/year likely just takes money from a protected environment and puts it in an unprotected one (the beneficiary's own account) for no discernible purpose.

10. Be cautious in drafting discretionary invasion provisions in Marital Trusts in multiple marriage situations. Those trusts are fraught with litigation peril. Consider a Marital Unitrust approach and limit or eliminate principal invasion.

11. Should income tax minimization be taken into account in making distribution decisions and if so, more or less so than other factors? For example, with the highest income tax rates hitting trusts at such low levels and the 3.8% surtax as well, do clients want trustees to disburse income (even if not needed) to beneficiaries to reduce income taxes? Or do clients prefer the excess income be accumulated in the trust at higher rates, but protected from creditors, divorcing spouses, estate taxes, etc?

C. Should Trustees be directed to prefer purchasing assets in trust name and allowing beneficiaries to use or live in them?

1. Many clients say "the trustee may make distributions to my child for HEMS".

2. The same clients may say the trustee can acquire assets in trust name and allow a beneficiary to use them rent-free.

3. Which result is preferred? If the client prefers buying assets in trust name to keep them protected, that should be stated.

4. Similarly, many trusts allow distributions to help a beneficiary invest in a business, but also allow the trust to invest in a business.

5. Again, which result is to be preferred? Whatever is preferred should be clearly stated

D. Consider drafting statements of wishes or intent clauses. Here is an example of an "Intent Clause"***:***

Grantor's Intent. It is Grantor's intent that the trusts established pursuant to this Article shall be used to provide economic protection to the beneficiaries and to enhance the beneficiaries' quality of life. In addition, Grantor would like the trusts under this Article to provide a source of funds in the event that a beneficiary does not have sufficient means or sources of income to provide for his or her own support. Despite the availability of trust assets, Grantor expects the beneficiaries to support themselves independently and to be productive members of their communities. Grantor does not desire that the beneficiaries become dependent upon distributions from the trusts to the extent that the beneficiaries lose their ambition and incentive to achieve. However, the direction herein shall not be construed to limit Trustee's discretion to enhance the retirement years of a beneficiary. When a beneficiary is able to be gainfully employed and is not actively engaged in raising children or in another activity or pursuit deemed worthwhile and appropriate by Trustee, Trustee should give due consideration in exercising Trustee's discretion to not using trust assets to replace the beneficiary's own efforts to work. However, Grantor does not intend that Trustee place undue emphasis on the amount a beneficiary earns if he or she is actively engaged in a worthwhile pursuit, including working as an unpaid volunteer for charitable purposes. In addition to the foregoing guidance, Grantor also requests, that the beneficiaries pursue higher education, to the best of their abilities and individual circumstances, but it is not Grantor's goal that Trustee reward professional students, nor punish those beneficiaries for whom life or individual circumstances indicate that the pursuit of higher education is not practical or advantageous. Grantor also intends that Trustee may consider using trust assets to help a beneficiary purchase a home or start a business or professional practice. For any such purposes, Trustee should consider acquiring such assets or investing in such ventures in the trust name. Grantor does not intend by these expressions of intent to bind Trustee or alter the absolute discretion that has been granted hereunder or create enforceable obligations to any beneficiary, but merely to provide general guidance to Trustee in the exercise of Trustee's discretion.

V. Drafting Powers of Appointment

A. First, be clear if you are drafting a special/limited power of appointment or a general power of appointment.

B. Second, if you are drafting a limited power does the client prefer the broadest limited power possible? For example: "beneficiary may appoint to anyone other than herself, her creditors, her estate or the creditors of her estate".

C. Or if you are drafting a limited power, does the client want it more limited? If the client prefers the standard class be more limited, you need to decide limited as to whom – descendants of the client, descendants and spouses, outright or in trust.

D. Should the beneficiary be able to appoint to charitable organizations?

E. Is the power exercisable during life or only at death? Gift taxes may be a concern if there is an intervivos exercise.

F. Is the power exercisable in a Will? May the power be exercised in other ways? If the power may be exercised otherwise, define the precise manner. For example, "this power of appointment may only be exercised in a Last Will duly admitted to probate within 90 days of the beneficiary's death" or "in a written instrument executed during the beneficiary's lifetime executed with the formalities required for a deed under Florida law and delivered to trustee."

G. Will a beneficiary's spouse (or anyone's spouse) be a permitted appointee? If so, consider limiting the ability to name a spouse as a beneficiary to some form of trust.

H. Example:

> <u>Power of Appointment</u>. Upon the death of the Primary Beneficiary, the balance of the Primary Beneficiary's trust shall be held in trust hereunder or distributed to or in trust for the benefit of such one or more of the Primary Beneficiary's descendants, Grantor's descendants, or charitable organizations (hereinafter collectively referred to in this Section as

“permissible appointees”), with such powers and in such manner and proportions as the Primary Beneficiary may appoint by Last Will making specific reference to this power of appointment. In addition to the foregoing, the Primary Beneficiary may exercise this power of appointment to distribute any portion of the Primary Beneficiary’s trust in trust for the benefit of the Primary Beneficiary’s surviving spouse (hereinafter referred to in this Section as a “surviving spouse”), provided that any portion so appointed for the benefit of a surviving spouse must be held in a trust that (1) prohibits principal distributions to the surviving spouse (however such trust may allow the trust’s net income (all or any fraction thereof, as the Primary Beneficiary may specify) to be distributed to the surviving spouse); and (2) requires that upon the death of the surviving spouse, the remaining trust principal must be distributed to one or more permissible appointees, as the Primary Beneficiary may designate.

I. Consider giving trust protectors the power to amend trust terms instead of giving broad powers of appointment

VI. Appointing Personal Representatives, Including Those Related to a Deceased Spouse

A. Statute - FS 733.304:

> 733.304 Nonresidents.—A person who is not domiciled in the state cannot qualify as personal representative unless the person is:
> (1) A legally adopted child or adoptive parent of the decedent;
> (2) Related by lineal consanguinity to the decedent;
> (3) A spouse or a brother, sister, uncle, aunt, nephew, or niece of the decedent, or someone related by lineal consanguinity to any such person; or
> (4) The spouse of a person otherwise qualified under this section.

B. This statute frustrates many a planner, probate lawyer and client alike. In fact, out of state planners are often caught naming nonqualified Personal Representatives. But Florida planners violate this statute frequently as well.

C. One issue comes up repeatedly: is a deceased spouse a "spouse" for purposes of 733.304(3)?

1. *Angelus v. Pass*, 868 So. 2d 571 (Fla. 3d DCA Feb. 11, 2004). Henry Pass filed a petition for administration that admitted he was a non-resident of Florida, but claimed that he was the decedent's nephew. Pass was appointed as a co-PR of the estate**.** Subsequently, in a hearing on a petition for his removal, Pass acknowledged that he was the nephew of the decedent's former (deceased) husband, not of the decedent. The court found that as a result Pass did not fall within the exception for non-residents who are relatives described in FS 733.304(3).

2. Therefore, a non-resident blood relative of a surviving spouse may serve, but a non-resident blood relative of a predeceased spouse may not.

D. If the spouse's relatives can't serve, can they be removed if they've been appointed by mistake?

1. In *Angelus v. Pass*, the 3rd DCA held that the 3 month time period did not bar an action for removal where the person appointed Personal Representative was never qualified to serve.

2. In *Hill v. Davis*, the FL Supreme Court sided with the 1st DCA in conflict with the 3rd DCA and found that the 3 month time limit was a bar on a claim of removal for lack of qualification. The court held:

"The issue before us is whether an objection to the qualifications of a personal representative of an estate is barred by the three-month filing deadline set forth in section 733.212(3), Florida Statutes (2007), a provision of the Florida Probate Code, when the objection is not filed within that statutory time frame. For the reasons explained below, we hold that section 733.212(3) bars an objection to the qualifications of a personal representative, including an objection that the personal representative was never qualified to serve, if the objection is not timely filed under this statute, except where fraud, misrepresentation, or misconduct with regard to the qualifications is not apparent on the face of the petition or discovered within the statutory time frame."

3. This holding is somewhat problematic as it would seem that at a minimum "misrepresentation" would be present on the face of every such petition if the non-qualified petitioner signs under penalties of perjury claiming to be qualified to serve. However, that's the law for now.

E. Sometimes people ask if the restriction on non-residents serving is even constitutional, but it is. See *In re Estate of Greenberg*, 390 So. 2d 40 (FLA 1980). In that case, the majority held that the restrictions on serving as a PR contained in FS 733.302 and 733.304 were constitutional. And the US Supreme Court dismissed the case, for lack of a substantial federal question.

VII. Failure to Plan for the Elective Share

A. One of Florida's most famous probate case – the estate of Joe Robbie – essentially boiled down to an estate plan that failed to consider and plan for the potential of an elective share claim.

1. There is more to the case and of course, there are back stories about fighting to control the family businesses, fighting to control the surviving spouse and warring factions in the large family. Thus, saying the Robbie case is just about a failure of elective share planning is too simplistic, but that estate certainly has been closely aligned with the subject.

B. The Florida Elective Share statute has been based on an augmented elective estate since passage in 1999.

C. 732.2035, FS includes in the elective estate, assets in the probate, estate, assets in a revocable trust, life insurance, IRAs and other "non-probate" assets passing via beneficiary designations, jointly held property and more.

D. However, FS 732.2075 allows for the satisfaction of the elective share via a trust.

E. FS 732.2095 describes how to value property in trust used to satisfy the elective share. It also permits contingent interests to be used. Thus, a provision in a will or revocable trust making an elective share trust contingent on the election should be viable.

F. A typical elective share marital trust will pay all income (the 50% level) and maybe even principal (to get to the 80% value level). If a trust is income only then about 60% of the estate must go into it (the 50% level), but if the trust allows a qualifying invasion (even if by a relatively unfriendly trustee), then only about 37.5% of the estate needs to go into the trust (the 80% level).

G. For an example of an elective share trust provision:

Exercise of Elective Share. If Grantor's spouse exercises Grantor's spouse's right to elect to take a share of Grantor's property in accordance with the provisions of Part II of

Chapter 732 of Florida law (or the similar or corresponding provision of the laws of that state where Grantor's spouse is domiciled at the time of Grantor's death) (the "Elective Share Provisions"), or if Grantor's spouse and Grantor are not married to each other at the time of Grantor's death, Grantor's spouse shall be deemed to have predeceased Grantor for purposes of this Agreement, and all rights and interests that depend upon a person surviving Grantor's spouse shall be determined and take effect as of Grantor's death. Notwithstanding the foregoing, if Grantor's spouse exercises Grantor's spouse's right to take a share of Grantor's property under the Elective Share Provisions, then Trustee shall set aside the smallest pecuniary amount necessary to satisfy the Elective Share Provisions with such amount to be held and administered as a separate trust (hereinafter the "Elective Share Trust") in which Trustee will only provide an income interest to Grantor's spouse and a Qualified Power of Invasion as described under Florida law. Grantor's spouse may never serve as Trustee of the Elective Share Trust.

VIII. Homestead Planning Issues

A. Many planners use standard will/revocable trust forms that split into Credit Shelter/Marital Trusts via formula disposition clauses for the surviving spouse with everything passing to trusts for children for life on the 2nd death - without addressing the homestead issues.

1. If the homestead winds up in one spouse's name, even if there are no minor children, there is the potential for a failed devise.

2. Consider drafting/adding into your forms a standard outright bequest of any homestead interest to the surviving spouse – like:

A. Distribution of Homestead. If (i) Grantor's spouse survives Grantor, (ii) Grantor owns an interest in homestead property as defined under Florida law ("Grantor's Homestead"), (iii) Grantor is not survived by a minor child, and (iv) Grantor's spouse does not have a waiver of homestead as described under Florida law, then Grantor directs Trustee to distribute all of Grantor's right, title and interest in and to Grantor's Homestead, outright, to Grantor's spouse.

3. Make clients aware of the risk of devising homestead to trusts for children (potential loss of the inurement of the creditor protection), and let it be their decision – not your nightmare.

a) In *Elmowitz v. Estate of Zimmerman*, 647 So.2d 1064 (Fla. 3d DCA 1994), the court held that homestead lost its protected status when the beneficiary had a mere income interest and no specific rights were granted to the use or occupancy of the homestead real property. The beneficiary's use of the property was at the discretion of the trustee, who could sell it without the beneficiary's consent.

b) Contrast *Elmowitz* to 2 cases saying devises to trusts were okay and the exemption inured. *HCA Gulf Coast Hospital v. Estate of Downing*, 594 So.2d 774 (Fla.

1st DCA 1992) (testamentary trust for daughter where the trustee had no real discretion and was said to be holding as nominee) and *Engelke v. Estate of Engelke*, 921 So.2d 693 (Fla. 4th DCA 2006) where the trust provisions gave the spouse a specific right to the use of the residence for life with the remainder to children from a prior marriage upon her death, and the courts ruled the homestead character inured to the trusts as beneficiaries.

B. Other clients direct that their real property be sold and the proceeds distributed to beneficiaries

1. Make sure it is made clear that if devised to an heir, under *Snyder v. Davis*, 699 So. 2d 999 (Fla. 1997), the exemption from creditors would inure and the property would pass exempt from claims.

2. Similar holdings were issued in *Moss v. Estate of Moss*, 777 So. 2d 1110 (Fla. 4th DCA 2001) (the brother of the decedent's deceased spouse and a niece were found within the class of heirs) and *Traeger v. Credit First Nat'l Ass'n*, 864 So. 2d 1188 (Fla. 5th DCA 2004) (the son of the decedent's deceased husband was held to be an heir to whom the exemption inured).

3. *McKean v. Warburton*, 919 So. 2d 341 (Fla. 2006) confirmed that protected homestead is not an asset in the hands of the PR and can't be used to pay creditors, expenses of administration or satisfy devises, even where it passes as part of the residue.

4. But, if the client directs a sale of the property, the bequest ceases to be a bequest of homestead and instead becomes "just" a bequest of money and as a result the proceeds become subject to the claims of creditors. *Estate of Price v. West Florida Hospital Inc*, 513 So. 2d 767 (Fla 1st DCA 1987) held that when the will contains a direction to sell the homestead and distribute the proceeds, the property loses its protected status. See also *Knadle v. Estate of Knadle*, 686 So. 2d 631, 632 (Fla. 1st DCA 1997), *Thompson v. Laney*, 766 So .2d 1087, 1088 (Fla. 3d

DCA 2000) and *Cutler v. Cutler*, 994 So. 2d 341 (Fla. 3d DCA 2008).

5. "Direction to sell" cases are a fairly hot topic in homestead litigation.

6. In *Engelke v. Estate of Engelke*, 921 So. 2d 693 (Fla. 4th DCA 2006), the court stated: "We have found no case in which a general direction to pay the estate expenses has trumped the constitutional homestead protections which are the rights of the heirs as much as the decedent. Therefore, unless the trust specifically directs that the freely devisable homestead be sold, the rights of the heirs attach at the death of the decedent, and the property is protected from the claims of all creditors." 921 So. 2d 693 at 697.

7. In *Cutler v. Cutler*, 994 So.2d 341 (Fla. 3d DCA 2008), although there was not an express, direction to sell the homestead, reading the estate plan as a whole, the court reasoned that "she did direct, in a specific manner, that it be used to satisfy her debts. This was the equivalent of ordering it sold and the proceeds distributed to pay debts."

C. Funding Credit Shelter trusts with homestead can be tricky, but in solid marriages, one option is to suggest an outright bequest to the surviving spouse with a direction that if disclaimed the homestead passes into the credit shelter trust.

1. A change in 2010 codified the treatment of a disclaimer by the surviving spouse of his or her interest in either a life estate or outright devise of protected homestead. F.S. §§732.401(4) and 732.4015(3) clarify that if the surviving spouse disclaims a life estate, the vested remainder beneficiaries then become the owners of the homestead property in proportion to their interests, and if the surviving spouse disclaims an outright devise the spouse will be treated as predeceasing the decedent and the interest will pass as otherwise provided in Chapter 739.

2. We are no longer stuck with the conflicting disclaimer cases: *Ryerson, Sudakoff* and *Janien.*

D. Unthinking use of 99 year leases

1. It appears 99 year leases may be used to retain homestead ad valorem tax benefits – *Higgs v. Warrick*, 994 So. 2d 492 (Fla. 3d D.C.A. Nov. 2008).

2. 99 year leases may have adverse section 2036 consequences and may be devise restricted homestead – Geraci case….

IX. Drafting Deeds

A. Deeds into and out of Trusts

1. Why do some advisors use Quit-Claim Deeds? You see them in divorces all the time.

2. Prefer warranty deeds so you don't "break the chain" of warranties and continue title insurance coverage. But since a title update likely wasn't done since the owner acquired title, to protect the grantor, you can state that the transfer is subject to: "Any matter created by, through, under or against the grantor named herein".

3. Don't draft deeds into trusts without trust powers:

> The Grantee, as trustee, has the full power and authority to protect, conserve, sell, convey, lease, encumber, and to otherwise manage and dispose of said real property pursuant to F.S. 689.071.

4. Consider if the deeded property qualified and continues to qualify for homestead ad valorem tax exemption and state such on the face of the deed. For example:

> Pursuant to the Trust Agreement [Grantor name] retains the requisite beneficial interest and possessory right in and to any real property placed in the Trust and used as his permanent residence so as to comply with Section 196.041 of the Florida Statutes, such that said beneficial interest and possessory right constitute, in all respects, "equitable title to real estate" as that term is used in Section 6, Article VII of the Constitution of the State of Florida. Thus, [Grantor name] is entitled to continue the benefits of the "homestead" exemption for ad valorem real property taxes including the "save our homes" protection.

5. If you didn't do a title update, you can state such on the deed. For example:

This instrument was prepared based on information provided by the Grantor and without the benefit of a current title examination.

6. If you draft a deed into or out of a trust, please correctly and fully identify it. Recently we had a transfer from X as trustee of the Z family QPRT dated 1/1/2001 to children A, B and C. But the Z family actually created two QPRT trusts (one by husband and one by wife) on the same date and each QPRT owned ½ the property. The deed didn't reveal which trust was transferring title. So a corrective deed was prepared from X as trustee of H's QPRT and X as trustee of W's QPRT (each as to ½ of the property) to the grantees.

B. Documentary Stamp Tax issues:

1. Funding LLCs and FLPs and distributions out have tax issues. In *Crescent Miami Center, LLC v. Florida Department of Revenue*, 903 So. 2d 913 (Fla. 2005), the FL Supreme Court said such conveyances of unencumbered real property from grantors to wholly owned entities are not subject to documentary stamp tax.

2. Subsequently there was an amendment to FS 201.02 in 2009 to tax sales of ownership in entities that own FL real property where the property was conveyed to the entity within 3 years of sale. And filing a notice of change of control of such entities is required under FS 193.1556.

3. Funding entities with Mortgaged property requires documentary stamp taxes based on consideration furnished.

4. Transferring homestead property between spouses with mortgages generally requires documentary stamps on ½ the mortgage.

X. Unlicensed Practice of Law

A. Common Situations:

1. We are asked to review documents that were created by non-Florida lawyers for their Florida clients

2. We are asked by a family member, client or referral source to draft an estate plan for someone who doesn't live in Florida.

3. We are involved in a litigation (perhaps a will contest, trust proceeding, trustee removal, or breach of duty case) and one party alleges another committed the unlicensed practice of law in Florida.

B. *FL Bar v. Larkin*, 298 So.2d 371 (Fla. 1974) held that the reparation of wills and antenuptial agreements by a person not authorized to practice law in Florida constituted the unlicensed practice of law.

C. In September 3, 2003, Florida Bar Staff Opinion 24894 was issued and stated that Florida attorneys should not communicate with out of state lawyers on matters involving Florida law. The issue specifically addressed was assisting an out of state lawyer interpreting a Florida real estate document, governed by Florida law.

D. Staff Opinion 24894 relied on FL Rules of Professional Conduct, 4-5.5(b) which prohibits a Florida lawyer from assisting or encouraging an out of state attorney in the unlicensed practice of law. In pertinent part the rule says:

> A lawyer shall not: (a) practice law in a jurisdiction where doing so violates the regulation of the legal profession in that jurisdiction; or (b) assist a person who is not a member of the (FL) bar in the performance of activity that constitutes the unlicensed practice of law (in FL).

E. Commentators (including the RPPTL Section) were concerned the Opinion also applied to those of us who were asked to review Florida estate planning documents prepared by non-Florida lawyers.

F. Subsequently Staff Opinion 24894 was withdrawn/modified by the division director who responded to the RPPTL section advising that a Florida attorney is not prohibited from reviewing documents, such as real estate deeds or estate planning documents, drafted by out of state attorneys.

G. As a result of the Opinion's withdrawal/modification, it is unclear if the law in Florida is still represented by the *Larkin* case.

H. Primarily, however, we are guided by Rule 4-5.5

> **RULE 4-5.5 UNLICENSED PRACTICE OF LAW; MULTIJURISDICTIONAL PRACTICE OF LAW**
>
> **(a) Practice of Law.** A lawyer shall not practice law in a jurisdiction other than the lawyer's home state, in violation of the regulation of the legal profession in that jurisdiction, or in violation of the regulation of the legal profession in the lawyer's home state or assist another in doing so.
>
> **(b) Prohibited Conduct.** A lawyer who is not admitted to practice in Florida shall not:
>
> > (1) except as authorized by other law, establish an office or other regular presence in Florida for the practice of law;
> > (2) hold out to the public or otherwise represent that the lawyer is admitted to practice law in Florida; or
> >
> > (3) appear in court, before an administrative agency, or before any other tribunal unless authorized to do so by the court, administrative agency, or tribunal pursuant to the applicable rules of the court, administrative agency, or tribunal.
>
> **(c) Authorized Temporary Practice by Lawyer Admitted in Another United States Jurisdiction.** A lawyer admitted and authorized to practice law in another United States jurisdiction who has been neither disbarred or suspended from practice in any jurisdiction, nor disciplined or held in contempt in Florida by reason of misconduct committed while engaged in the practice of law permitted pursuant to this rule, may provide legal services on a temporary basis in Florida that:
>
> > (1) are undertaken in association with a lawyer who is admitted to practice in Florida and who actively participates in the matter; or

(2) are in or reasonably related to a pending or potential proceeding before a tribunal in this or another jurisdiction, if the lawyer is authorized by law or order to appear in such proceeding or reasonably expects to be so authorized; or

(3) are in or reasonably related to a pending or potential arbitration, mediation, or other alternative dispute resolution proceeding in this or another jurisdiction, and the services are not services for which the forum requires pro hac vice admission:

(A) if the services are performed for a client who resides in or has an office in the lawyer's home state, or
(B) where the services arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice; or

(4) are not within subdivisions (c)(2) or (c)(3), and

(A) are performed for a client who resides in or has an office in the jurisdiction in which the lawyer is authorized to practice, or
(B) arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice.

Comment

Other than as authorized by law, a lawyer who is not admitted to practice in Florida violates subdivision (b) if the lawyer establishes an office or other regular presence in Florida for the practice of law. Presence may be regular even if the lawyer is not physically present here. Such a lawyer must not hold out to the public or otherwise represent that the lawyer is admitted to practice law in Florida.

There are occasions in which a lawyer admitted and authorized to practice in another United States jurisdiction or in a non-United States jurisdiction may provide legal services <u>on a temporary basis</u> in Florida under circumstances that do not create an unreasonable risk to the interests of his or her clients, the public,

> or the courts. Subdivisions (c) and (d) identify such circumstances. <u>This rule does not authorize a lawyer to establish an office or other regular presence in Florida without being admitted to practice generally here</u>.
>
> There is no single test to determine whether a lawyer's services are provided on a "<u>temporary basis</u>" in Florida and may therefore be permissible under subdivision (c). Services may be "temporary" even though the lawyer provides services in Florida on a recurring basis or for an extended period of time, as when the lawyer is representing a client in a single lengthy negotiation or litigation.

I. Rule 4-5.5 focuses on the conduct of the lawyer. It says an out of state lawyer may not establish an office or other regular presence in Florida for the practice of law. So being present or holding one's self out as a Florida practitioner is forbidden. It does not appear that drafting a will for a Floridian from your office in New York is forbidden, so long as you didn't come to Florida to solicit clients and/or set up an office here or have any other regular presence in Florida. Similarly, it seems that a Florida lawyer asked to draft a will for a family member of a client who lives outside Florida likely isn't committing the unlicensed practice in that other state, but you should always check the state's rules.

J. The better practice, however, and the one that also protects against malpractice, is to associate with local counsel in the other jurisdiction for help and review.

K. What about allegations of unlicensed practice in litigation? This seems to be a rising trend. Well, the law is actually clear and this is a trend we should nip in the bud.

L. The law on standing to enforce the rules against the unlicensed practice of law may be summarized as follows:

> The Florida Supreme Court's exclusive jurisdiction over the discipline of lawyers carries with it the power to prevent the unlicensed practice of law. Florida Bar v. Smania, 701 So. 2d 835, 836 n.1 (Fla. 1997); FL Rule 10-1.1. Only the Florida Bar, as the official arm of the Supreme Court, has standing to enforce the rules relating

> to the unlicensed practice of law. See FL Rule 10-1.2. Neither an attorney, nor a local bar association, nor a private litigant has standing to bring an action to enjoin the unlicensed practice of law. Heilman v. Suburban Coastal Corp., 506 So. 2d 1088, 1089 (Fla. 4th DCA 1987); Sigma Fin. Corp. v. Investment Loss Recovery Servs. Inc., 673 So. 2d 572 (Fla. 4th DCA 1996); Dade-Commonwealth Title Ins. Co. v. North Dade Bar Ass'n, 152 So. 2d 723 (Fla. 1963).

http://www.law.cornell.edu/ethics/fl/narr/FL_NARR_5.HTM

From the *Heilman* decision

> Further, Heilman does not have standing in court to complain about the activities of another which may or may not be the unauthorized practice of law. In *Dade-Commonwealth Title Insurance Company v. North Dade Bar Association*, 152 So.2d 723 (Fla. 1963), the supreme court held that a suit to enjoin title companies from causing legal documents to be prepared by their agents in consummating real estate transfers and mortgages because it constituted the unauthorized practice of law could not be maintained even by an attorney or a local bar association. Such a suit can be brought only by the Florida Bar as the official arm of the supreme court, and neither an attorney or a local bar association has standing to bring such an action.

XI. Bonus – Reflexive Use of 529 Plans

A. Financial advisors advise many clients to use Section 529 plans for their children and grandchildren, but for many clients there may be more tax efficient ways to fund education and gifting/wealth transfer.

B. 529 accounts are very popular for a number of good reasons.

1. The assets in a 529 plan grow tax fee and if used for education come out tax free also.

2. Clients can front-load 5 years of annual gifts into them.

3. Clients can control them and even have access to the funds in them.

C. However, there are drawbacks to 529 plans.

1. If the funds are not used for qualified higher education expenses, then they are subject to income tax as ordinary income plus there is a 10% penalty.

2. Investment choices are typically limited.

3. You can't put in discounted assets.

D. Many clients will gain greater wealth transfer tax benefits by making annual gifts to "crummey" trusts for grandchild and then paying education expenses directly and out of pocket. Since paying education expenses is not a gift, that can be done along with and in addition to the annual gifts; whereas annual gifts to a 529 will be used for education and reduce the amount of education a client can pay in the future.

E. Money in a 529 plan must be used on education by age 30 or there is a penalty. But money put in trust can be used for anything.

F. Annual gifts to a crummey trust may have income tax/wealth transfer benefits if the client makes the trusts grantor trusts for income tax purposes.

G. There is no cap on the total amount one can gift to crummey trusts (other than the annual exclusion and $5.25m exemption), but there are limits on contributions to 529 accounts.

H. The 529 plans make it hard (or impossible) to pay education expenses and annual gifts while the beneficiary is in school. Whereas when making gifts in trust, if the gifted assets are not needed to pay education and if the client can afford, annual gifts can continue while the client also pays education expenses directly.

I. As a result, for wealthy clients who can and are willing, the total wealth transfer benefit and the total benefit to the grandchild (for example) may be significantly greater for clients who fund crummey trusts and pay education directly.