Summer 2022

Estate Planning Update Summer 2022 - Community Property Comes to Florida

In 2021, Florida joined Alaska, South Dakota, Kentucky and Tennessee to allow for certain assets owned by married couples to be owned as "community property," despite none of these states being "traditional" community property states. A community property state is one that treats all assets acquired during the marriage as being owned by both spouses, even when the assets are not actually titled in joint names.

Florida law already allowed married couples moving into Florida from a traditional community property state to retain the community property status of their marital assets. Now, Florida permits married couples to create a wholly new community property interest, even if they never lived in a community property state.

The benefit of community property is advantageous income tax treatment for the community property asset. You may be familiar with the concept of "basis" for income tax purposes. Generally, when an asset is sold, the taxpayer must report capital gain or loss, which the taxpayer calculates by subtracting his "basis" from the sale price for the asset. As a general rule, "basis" is what a person paid for the asset that is later sold; however, when an asset is received by a person because the owner died, the basis of that asset in the hands of the new owner is "stepped up" to the fair market value of the asset on the date of the prior owner's death.

In a separate property state (like Florida), jointly-held property is considered as being owned one-half by each spouse. Thus, when one spouse dies, the surviving spouse will only receive a stepped-up income tax basis as to one-half of the property. If the asset is community property, however, the entire interest in the community property receives a full step-up in income tax basis on the first spouse's death. This step-up can be incredibly valuable to the surviving spouse and the family, as it can eliminate or substantially reduce any capital gains incurred upon a sale subsequent to the deceased spouse's death. This technique is available to any taxpayer regardless of personal wealth and is beneficial for any married couple with appreciated assets. Except for the states mentioned above, this benefit has not previously been available to taxpayers who did not reside in a community property state.

To opt in to community property treatment, the married couple must transfer the property to, or have it acquired by, a Florida Community Property Trust (the "Trust"). To properly qualify, the Trust must meet specific requirements. First, the Trust must contain special language that manifests the intention to own community property. Second, the spouses must be the only qualified beneficiaries of the Trust when both are living. Third, the trustee of the Trust must either be a Florida resident or banking institution authorized to conduct business in Florida.

While beneficial, this technique is not without risk. Generally, the IRS is bound by state law property determinations; however, it is unclear whether the IRS will ultimately accept a community property "opt-in" from an otherwise separate property state. While similar laws in other states have been around for more than two decades, the IRS has not provided specific guidance on this Florida law. Additionally, a Community Property Trust may expose Trust assets to the creditors of both spouses. Those assets otherwise would have been protected had the assets been held separately by the non-creditor spouse. There may also be implications should the married couple later divorce. It is important to understand these risks prior to implementing this strategy.

In addition to being a great estate planning strategy for Florida residents, the Florida Community Property Trust may be an opportunity for residents of other states who can identify a Florida Trustee. As always, please contact our firm's attorneys if

you are interested in learning more about the opportunity to add a new component to your estate plan with potential for substantial income tax savings.

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