WHITE PAPER

PROPOSED § 732.4017 , FLA. STAT.

I. SUMMARY

There is confusion regarding the alienation of homestead real property in the State of Florida. Article X, Section 4(c) of the Florida Constitution expressly permits the owner of homestead real estate, joined by the owner's spouse if married, to alienate homestead property by mortgage, sale or gift. The constitution only prohibits devises of homestead property if the owner is survived by a spouse or minor child. The term "devise" is defined in the Florida Probate Code, not in the Florida constitution. F.S. § 731.201(10) defines a "devise" as a testamentary disposition of real or personal property. While a lifetime alienation (as opposed to a devise upon death) of homestead real estate is expressly permitted by the Florida Constitution, there have been several cases in Florida in which the courts have determined that attempted transfers of homestead real estate by the owners during their lifetime was not properly characterized as an "alienation" of that homestead real property but was in reality an attempted testamentary devise of the homestead real property. One case involved a deed executed by the owner of the homestead real property in which certain rights were retained by the owner and another case involved the transfer of homestead real property to a revocable living trust by the owner during his lifetime. See *Johns v. Bowden*, 66 So. 155 (Fla. 1914) and *In re Estate of Johnson*, 398 So.2d 970 (Fla. 4th DCA 1981). The applicable case law has left confusion and uncertainty as to what types of lifetime transfers would qualify as a permitted "alienation" of the homestead real property pursuant to Article X, Section 4(c) of the Florida Constitution. The proposed statute is to clarify the law in this area and provide guidance to the residents of Florida and various practitioners working in this area as to what types of lifetime transfers would be permissible under the constitution and statutory law. The drafters of the proposed statute believe that the statute is only codifying and clarifying existing law and would not be creating new law or changing existing law.

II. CURRENT SITUATION

Article X, section 4(c) of the Florida constitution expressly permits the owner of homestead real estate, joined by the owner's spouse if married, to alienate homestead property by mortgage, sale or gift. The constitution only prohibits devises of homestead property if the owner is survived by a spouse or minor child. The term "devise" is defined in the Florida Probate Code, not in the Florida constitution. Section 732.201(10) defines a "devise" as a testamentary disposition of real or personal property.

Two Florida appellate cases have invalidated attempted dispositions of homestead property made by lifetime conveyances in which the transferors retained certain rights in the homestead real property either by deed or by trust. *Johns v. Bowden*, 68 Fla. 32, 66 So. 155 (1914) (deed containing terms of trust); *In re Estate of Johnson*, 398 So.2d 970 (Fla. 4th DCA 1981) (quitclaim deed to trustee of revocable trust). Although in each case the trust or deed terms provided for a specific disposition of the homestead property upon the settlor's death, the settlor retained the right during lifetime to direct a conveyance of the title and the entire

beneficial interest to other persons (including the settlor) at the settlor's pleasure. Thus the interest in the homestead property that was conveyed was not a vested right in the property to any of the beneficiaries named in the trust instrument, but was a contingent interest subject to the right of the settlor to direct the trustee to convey the property to others during the settlor's lifetime. Because of the retention of the entire beneficial estate in the settlor during life, in each case the trust instrument was in effect an attempted testamentary disposition of homestead property in contravention of the restrictions set forth in the Florida constitution.

Based on these two seminal cases, practitioners in this area, including title companies and attorneys engaged in estate planning, are not certain as to what the courts of this state will hold regarding certain types of lifetime transfers which the drafters of the proposed statute believe are permissible under the Florida Constitution and Florida statutory law.

III. EFFECT OF PROPOSED CHANGE

The proposed statute makes it clear that an inter vivos conveyance of an interest in homestead property will not be considered a "devise," provided that certain conditions are met. If those conditions are met, an interest in homestead property that is conveyed inter vivos will not be subject to the restrictions on devise of homestead property upon death, even without a waiver of homestead rights by the surviving spouse, because the interest will have been alienated for property law purposes during the homestead owner's lifetime, without retention of the entire beneficial estate in the settlor, and thus will not be owned for purposes of descent and devise upon death.

The beneficial effect of the statute will be to create a comfort level for the residents of the State of Florida when they are attempting to plan with their residence, which in most cases is their most valuable asset. Both title companies and attorneys who are engaged in estate planning will better be able to assist their clients in providing advice to their clients about their house and under what circumstances it will be permissible and advisable to engage in a lifetime alienation of their residence. The courts of the State of Florida will also be provided with a defined set of rules under which they can review situations involving the lifetime alienation of homestead real property.

The proposed statute would be most useful in situations where a divorced or widowed parent has minor children and wishes to transfer his or her homestead into an irrevocable trust in order to avoid the homestead being placed in a guardianship if that parent dies before his or her minor children reach 18 years of age. The drafters of the proposed statute believe that the statute is only codifying and clarifying existing law and would not be creating new law or changing existing law.

IV. ANALYSIS

Subsection (1) of the proposed statute sets forth two essential requirements: (1) there must be a valid inter vivos conveyance of an interest to one or more persons other than the homestead owner, and (2) the homestead owner cannot have the power, acting in any capacity, whether alone or in conjunction with another person, to revoke the interest that is conveyed, or to

revest the interest in the owner. The conveyance can be outright (such as a deed of a remainder interest to a named individual), or it can be in trust for the benefit of one or more beneficiaries.

Subsection (2) applies to conveyances made in trust, and permits the owner of the homestead property to retain a power to alter the beneficial use and enjoyment by any one or more of the beneficiaries of the trust, as long as the power cannot be exercised in favor of the owner, the owner's creditors, the owner's estate, or the creditors of the owner's estate, or in a manner that would discharge a legal obligation of the owner. The owner can exercise a power to alter the interests of beneficiaries who are identified in the trust instrument, but cannot exercise it in favor of persons not included in the class of beneficiaries identified in the trust instrument. For example, if the trust is a discretionary trust for the benefit of the owner's descendants living from time to time, the owner can exercise a power to exclude a child of the owner as a beneficiary, or to change the ages specified for outright distributions, but the owner could not direct that distributions be made to the owner's spouse or to anyone else not a descendant of the owner. The power can be only be exercised during the owner's lifetime, and thus cannot be exercised by will.

Retention of such a power usually will be necessary in order to avoid immediate gift tax consequences upon the transfer of an interest in the homestead property, even if the owner retains a separate interest in the property (because of the rules under Section 2702 of the Internal Revenue Code). For example, if the owner of homestead property conveys the homestead property to an irrevocable discretionary sprinkling trust for the benefit of the owner's descendants living from time to time, the full fair market value of the property will be subject to gift tax even if the owner retains a life estate in the homestead (because under Section 2702 of the Internal Revenue Code there is no offset for any interest retained by the owner other than an annuity or unitrust interest). Retention of a power to alter the beneficial use or enjoyment of the interest conveyed (whether the power is limited in scope or is unlimited) will eliminate immediate gift tax consequences even if the power is limited in its scope, by utilizing the incomplete gift rules under Section 2511 of the Internal Revenue Code.

The language of subsection (2) follows the terminology used in Section 2041 of the Internal Revenue Code, which provides that certain limited powers of appointment will not cause property subject to the power to be included in the gross estate of the holder of the power. Use of that terminology is appropriate in subsection (2) of the proposed statute not because of estate tax reasons, because retention by a settlor of any power to alter the beneficial use or enjoyment by others of property held in trust ordinarily will cause the property to be included in the settlor's gross estate, whether the power is limited or is general. Rather, the terminology of Section 2041 of the Internal Revenue Code sets forth a clear demarcation line between the types of powers in which the holder of the power has a personal economic interest and those in which the holder of the power has no direct or indirect personal economic interest. In both the *Johns* and *Estate of Johnson* cases, *supra*, the homestead owner had retained the entire beneficial interest and right in the property, such that no interest could pass to other persons until the owner's death. The types of retained powers in those cases were so broad and unlimited that by their very nature the settlor of the trust had retained the entire beneficial estate in the homestead property. As noted by the Florida Supreme Court in *Johns*:

> Because of the retention of the entire beneficial estate in the grantor during his life, the instrument, in practical effect, is in the nature of a testamentary disposition of property alleged to be a homestead, and a testamentary disposition of homestead property is forbidden by law when the testator leaves a wife or child.
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> If the property was, and continued to be, in fact and in law, a homestead, the alleged trust deed, not being an absolute conveyance of any vested estate in the land to take effect during the grantor's lifetime, is apparently ineffectual for the purpose designed. [66 So. at 159]

The terminology used in Section 2041 of the Internal Revenue Code differentiates between powers which cannot benefit the holder of the power either directly (by exercising it in favor of the owner or the owner's estate) or indirectly (by exercising the power in favor of creditors of the owner or the owner's estate, or in ways that discharge a legal obligation of the owner), and powers which the holder can use for his or her own benefit. Use of that terminology in subsection (2) of the proposed statute confines the scope of powers which can be retained by the owner over disposition of the homestead property to those which cannot benefit the owner either directly or indirectly; it requires that interests which pass to other persons during the owner's lifetime do so irrevocably; and it makes it impossible for the owner to retain the entire beneficial interest and right in the property. These requirements will eliminate the attributes of the revocable transfers which caused the courts to invalidate the purported transfers in *Johns* and in *Estate of Johnson*).

Subsection (3) of the proposed statute clarifies that if an inter vivos conveyance satisfies the requirements of subsection (1) of the proposed statute, the owner can retain separate interests in the homestead property, such as a life estate (which would be desirable if the owner intends to continue to occupy the homestead property and wishes to retain homestead property tax benefits such as the Save Our Homes cap on increases in assessed taxable value). Interests that satisfy the requirements of subsection (1) of the proposed statute will not be treated as testamentary in nature even if they are future interests, such as a remainder interest following a life estate retained by the homestead owner. Furthermore, an interest that satisfies the requirements of subsection (1) of the proposed statute is not testamentary in nature even if the interest is subject to extinction upon the occurrence of an irrevocably specified event or contingency, such as the owner being alive on a date when all of the owner's children have reached the age of majority (at which time the constitutional restrictions on devise would no longer exist).

The following are examples of qualifying inter vivos conveyances that are not subject to the constitutional and statutory restrictions on the devise of homestead property (whether or not the owner is survived by a spouse or minor child, assuming that all other conveyancing requirements have been met). It is assumed in each example that the homestead owner does not retain a power in any capacity, acting alone or in conjunction with any other person, to revest the conveyed interest in him or herself:

1. An inter vivos conveyance to a qualified personal residence trust (within the meaning of section 2702 of the Internal Revenue Code).

2. An inter vivos conveyance of a remainder interest in homestead property (whether outright or in trust) following a life estate retained by the owner.

3. An inter vivos conveyance of a remainder interest in homestead property that is subject to complete divestment if the owner of the homestead property survives to a date that is specified in the instrument of conveyance, or if the conveyance is in trust, to a date that is specified in the trust instrument. (Example: a vested remainder interest that is subject to divestment with a reversion back to the homestead owner if he or she is still alive on a specified date, or that is subject to divestment with a reversion back to the owner's estate if he or she is not survived by a minor child upon his or her death).

It should be sufficiently clear that conveyance of an interest that meets the requirements of the proposed statute will not cause the homestead owner's retained interest to be revalued for assessment purposes, as long as the person conveying the interest retains a life estate or other interest that qualifies as homestead for real property tax purposes under current law.

V. FISCAL IMPACT ON STATE AND LOCAL GOVERNMENTS

The proposal does not have a fiscal impact on state governments but may create a positive tax effect on local governments as there may be a taxable event upon certain inter vivos transfers of homestead real property.

VI. DIRECT IMPACT ON PRIVATE SECTOR

The proposal will not have a direct economic impact on the private sector.

VII. CONSTITUTIONAL ISSUES

There appear to be no constitutional issues raised by this proposal as the drafters of the statute believe that it is only codifying existing law and is consistent with Article X, Section 4(c) of the Florida Constitution.

VIII. OTHER INTERESTED PARTIES

None are known at this time.

IX. TEXT OF PROPOSED F.S. 732.4017

732.4017 Inter vivos transfer of homestead property. –

(1) If the owner of homestead property transfers an interest in that property, with or without consideration, to one or more other persons during the owner's lifetime, including a transfer in trust, the transfer shall not be a devise for purposes of s. 731.201(10) or s. 732.4015, and the interest transferred shall not descend as provided in s. 732.401, if the transferor does not retain a power, held in any capacity, acting alone or in conjunction with any other person to revoke or revest that interest in the transferor.

(2) A "transfer in trust" for purposes of this section shall refer to a trust where the transferor of the homestead property, either alone or in conjunction with any other person, does not possess a right of revocation as that term is defined in s. 733.707(3)(e). A power possessed by the transferor exercisable during the transferor's lifetime to alter the beneficial use and enjoyment of the interest only within a class of beneficiaries as identified in the trust instrument is not a right of revocation if the power cannot be exercised in favor of the transferor, the transferor's creditors, the transferor's estate, the creditors of the transferor's estate, or in discharge of the transferor's legal obligations. Nothing in this subsection shall be construed as creating an inference that a power not described in this subsection is a power to revoke or revest an interest in the transferor.

(3) The transfer of an interest in homestead property described in subsection (1) shall not be treated as a devise of that interest even if:

(a) the transferor retains a separate legal or equitable interest in the homestead property, whether directly or indirectly through a trust or other arrangement, such as a term of years, life estate, reversion, possibility of reverter, or fractional fee interest;

(b) the interest transferred will not become a possessory interest until a date certain or upon a specified event the occurrence or nonoccurrence of which does not constitute a power held by the transferor to revoke or revest the interest in the transferor, including without limitation, the death of the transferor; or

(c) the interest transferred is subject to divestment, expiration, or lapse upon a date certain or upon a specified event the occurrence or nonoccurrence of which does not constitute a power held by the transferor to revoke or revest the interest in the transferor, including without limitation survival of the transferor.