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Leaving New York Tax 'Potholes' And Avoiding Florida Homestead 'Sinkholes'

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As New York income and estate taxes go up, many New Yorkers are going down—to tax-friendly Florida. There are significant tax and creditor protection benefits to establishing Florida domicile and declaring Florida homestead, but one must be careful not to run afoul of the legal qualifications for Florida homestead protection. The term “homestead,” as addressed in this article, refers to the real property that a person legally domiciled in Florida claims as his or her primary Florida residence. In that context, “homestead” can include many classes of “residences.”¹

There are three distinct aspects of Florida homestead: property tax exemption; creditor protection from forced sale; and restrictions on probate/devise and descent. Depending on whether one is seeking property tax exemption benefits, creditor protection benefits, or application of post-mortem statutes to the disposition of the property, the “hoops” to go through in order to qualify one’s primary Florida residence as his or her homestead will differ. What is “homestead” for one purpose may not qualify for all purposes.

Property Tax Exemptions

Every person who has legal or beneficial title in equity to Florida realty and “in good faith makes the same his or her permanent residence” or the permanent residence of one or more others who are legally or naturally dependent on that person, on Jan. 1, has the right to apply for this exemption for that year.² There are no property size restrictions on the homestead for this tax exemption.³ The first benefit is a \$50,000 reduction in the “just value”

for the annual computation of the tax assessment value.⁴ This exemption may be augmented by modest additional exemptions for widows, certain veterans, blind persons, certain seniors, and totally disabled persons.⁵

While one’s primary residence will obtain the **property tax exemption** regardless of acreage, only that portion that meets the constitutional size limitations will receive **creditor protection**.

The second benefit is that the annual homestead reassessment amount is capped at the lower of 3 percent or the percent change in the Consumer Price Index for the preceding calendar year.⁶ In an escalating real estate market, this cap will keep the real estate tax bill of Florida domiciliaries much lower over time than if they never declared Florida as their domicile. Although, arguably, Florida has been hit the hardest on real estate value decline, it has seen significant increases in real estate values in the past and will most likely experience some increase in the future. The enigma of this benefit is that the Florida-domiciled neighbor of a New York domiciliary, with the same house



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(plan/lot) may enjoy the benefit of significantly lower real estate taxes, assuming they bought their houses at the same time.⁷

Beware, however, since this benefit attaches on Jan. 1, this property tax benefit can be turned into a “sinkhole” if the property owner fails to (i) take ownership and (ii) take up residence in the homestead by midnight Dec. 31 of the preceding year. The property owner must also file a properly completed homestead application with the county property appraiser before March 1 of the taxable year.⁸ This exemption will be applicable beginning Jan. 1 of the year following the establishment of the property as one’s qualified homestead.

The initial “just value” for property tax is generally based on the purchase/acquisition price; but, if the acquisition is for less than fair market value, then the full fair market value will be assessed as the “just value.”⁹ This can become a surprising “sinkhole” in the context of gifted/inherited property and property that is sold or transferred to an entity for less than adequate consideration. Any non-exempt change in ownership will trigger reassessment, without regard to the cap.¹⁰

Examples of exempt changes are: transfers between spouses (including to a surviving spouse or due to divorce); and transfers to a revocable trust, where the transferor is the trust beneficiary.¹¹ Caveat: In transferring homestead to entities such as a QPRT (qualified personal residence trust) or a revocable trust, there is unique trust language that each separate county appraiser will require in order to retain the homestead qualification. It is crucial that the recorded deed and the qualifying trust provisions be timely submitted to the property appraiser for approval for continuation of the homestead qualification.¹²

Florida’s property tax exemption provisions also provide a benefit to Florida domiciliaries who decide to upgrade or downsize for retire-

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ment. Florida homestead law allows the seller to carry over up to \$500,000 in assessment cap value, if the new homestead is more expensive than the former; and allows a percentage carry-over for a downsized homestead.¹³ Caveat: To perfect this benefit, the new homestead must be acquired within two years of abandonment or sale of the prior homestead; and the owner of the new homestead must timely file a properly completed transfer application with the property appraiser.¹⁴

Conversely, if one were to buy a residence in Florida as a vacation home or what is otherwise not a qualified homestead residence, there is no homestead exemption from the just value assessment base; and the annual valuation cap is 10 percent of the value of the property for the prior year.¹⁵ Since there was no assessment cap on non-homestead property in prior years, this is a new benefit for New Yorkers who are not ready to declare Florida domicile.

Creditor Protection

In order for a homestead to be exempt from forced sale by creditors, the property owner must be a "natural person" (including the grantor of a revocable trust of which the grantor is the beneficiary), and one is limited in the size and scope of the property. The exemption is for up to one-half acre of contiguous land and the residence of the owner (and his or her family) thereon, within a municipality; or up to 160 acres of contiguous land and the improvements thereon, outside a municipality.¹⁶ This prevents "forced sale," with notable exceptions: payment of taxes, property assessments, mortgages, mechanics' liens, etc.¹⁷ LLCs and similar entities are ineligible for protection due to not being "natural" persons.¹⁸

The difference between property within and outside a municipality is critical. If a person purchases property in excess of one-half acre, and no more than 160 contiguous acres, at a time when it is outside a municipality, but the property is later incorporated into a municipality, then the land and the improvements thereon will continue exempt from forced sale—for that owner only.¹⁹ Caveat: Upon sale, only one-half acre and the owner's (and/or family) residence thereon will be exempt for the new owner.

New Yorkers beware: While one's primary residence will obtain the property tax exemption regardless of acreage, only that portion that meets the constitutional size limitations will receive creditor protection. If you reside within a municipality on greater than one-half acre, your creditors can force a sale of your homestead and seize the proceeds in excess of the value of the protected one-half acre. This is contrary to what many expect when filing for homestead. Although the author is familiar with a technique to mitigate this exposure in certain circumstances, there is no test case to date.

Bankruptcy is a homestead issue. Under the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) and Florida's opt-out,²⁰ there arose a 1,215-day look-back period for homestead bankruptcy exemptions. Generally, if the buyer purchases a homestead residence, then files for bankruptcy within 1,215

days of the date of purchase, and the buyer is not a "farmer," the buyer's bankruptcy exemption is limited to \$125,000.²¹ Tracing of proceeds of sale of a previously owned homestead to buy a new homestead has been allowed, and can increase the sheltered amount for the new homestead.²²

Caveat: New Yorkers should pay heed to both the size of their lots and the type of buildings thereon, and consider purchasing their homesteads as tenants by the entireties, if there is any chance that they may need to file for bankruptcy protection within the 1,215-day period. It has been held that, when a husband and wife file a joint bankruptcy petition within the look-back period, if they own their homestead as tenants by the entireties, each spouse is entitled to the full \$125,000 exemption—effectively doubling the exemption.²³ This should inure to joint tenants with right of survivorship property.²⁴ Note: New Yorkers with Florida vacation homes should find that entireties property is exempt if only one spouse files and the creditors are not creditors of both spouses.²⁵

Probate/Devise and Descent

To the surprise of many, homestead is not part of the probate estate of a decedent, even if owned in the decedent's individual name. Again, this is limited to property owned by a "natural person."²⁶ Homestead passes outside probate, for descent and distribution purposes.²⁷ However, a homestead determination must be made by the court.²⁸

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If there are minor children, homestead may not be devised—even to a surviving spouse. Otherwise, if there is a surviving spouse, the devise must be to that spouse, outright. Sections 732.401(1), 732.4015, Florida Statutes, add that if the decedent is survived by a spouse and lineal descendants, the surviving spouse receives a life estate, "with a vested remainder to the lineal descendants in being at the death of the decedent, per stirpes." This also applies to homestead held in a decedent's revocable trust.²⁹ These restrictions on the devise of homestead can be waived by the spouse, if done properly.

These provisions pose problems for Florida domiciliaries whose main asset may be their homesteads. Funding credit shelter trusts without using the homestead may be infeasible unless one spouse owns the homestead and the other spouse waives all homestead rights. Homestead waivers may be done, but there are statutory and common law rules that place special requirements, including separate counsel and fair disclosure of assets between the spouses, for a formal pre- or post-nuptial

homestead waiver to be valid. If there is a minor child at the death of the owner, the waiver is void.³⁰ Although there are ways to mitigate this situation, this can be a particularly difficult issue in second marriages.

Caveat: Under case law, if a homestead owner's will directs that the homestead be sold and the proceeds distributed—even to protected persons, then the proceeds lose the homestead protection for all purposes.³¹ Careful drafting will mitigate this situation.

There are many permutations to homestead rights, benefits, and restrictions that are unique to Florida. Proper counseling of New Yorkers moving to Florida requires intimate knowledge of the application of Florida's homestead law to all aspects of a client's estate planning and asset protection goals.

1. Section 196.031(1)(a), Fla. Stat. This exemption also applies to most mobile homes; to condos and co-ops; and to leaseholds initially in excess of 98 years.

2. Id.; §196.041 (1), Fla. Stat.

3. Section 196.011, Fla. Stat.

4. There is an annual reassessment of tax value. Section 193.155(1), Fla. Stat.

5. See, generally, §196, Fla. Stat.

6. Section 193.155, Fla. Stat., see Fla. Const., art. VII §4(d)

7. Caveat: "Just value" is established on Jan. 1 each year, and this reassessment will allow the assessment value to be increased above the cap, if there have been material improvements or additions to the property; and may be reduced, in the event of a reduction in value due to material damage to the property. Section 193.155(4), Fla. Stat.

8. Section 196.011 (1), Fla. Stat. Note: This is a notarized form, requiring the legal description of the property being declared as homestead, which must be recorded in the county where the property is located.

9. Fla. Const. art. VII, §4(d)(3), (4)

10. Section 193.155(3), Fla. Stat.

11. Id.

12. See, Op. Atty. Gen. Fla. 072-12 (Jan. 11, 1972); Note: There are also special terms required for other trusts, such as QTIPs. Id.

13. Section 196.011(8), Fla. Stat.

14. Sections 196.011 (1), (8), Fla. Stat.

15. Sections 193.155(1), (3), Fla. Stat.

16. Fla. Const. art. X, §4(a)(1).

17. Id.; see, e.g., *In re Edwards*, 356 B.R. 807 (Bankr. M.D. Fla. 2006).

18. E.g., *In re Terri L. Steffen*, 405 B.R. 486 (Bankr. M.D. Fla. 2009).

19. Id.

20. Section 222.201, Fla. Stat.

21. BAPCPA §522(p)

22. *In re Wayrynen*, 331 B.R. 479 (Bankr. S.D. Fla. 2005) (citing BAPCPA §522(o)).

23. *In re Rasmussen*, 349 B.R. 747 (Bankr. M.D. Fla. 2006) (citing, inter alia, BAPCPA §522(m), (p)).

24. See, id.

25. See, *In re Davis*, 403 B.R. 914 (Bankr. M.D. Fla. 2009); see, also §522(b)(2)(B) BAPCPA; §§222.01-.02, .05, .07, Fla. Stat.

26. Fla. Const. art. X, §4.

27. Sections 732.401(1), 732.402(4), (7) Fla. Stat.

28. Fla. Prob. R. 5.405.

29. Sections 732.401(2)(a), (b).

30. Section 732.702, Fla. Stat., see, e.g., *City Nat'l Bank of Fla. v. Tescher*, 578 So. 2d 701 (Fla. 1991); see, also, ch. 61, Fla. Stat.

31. *McKean v. Warburton*, 919 So.2d 341, 346 (Fla. 2005).