Estate planning for the Florida resident

Key Private Bank

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About the author

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Mr. Eardley is a frequent lecturer and published author on various estate planning topics, including Florida residency planning and international estate planning. His most recent articles include *Establishing a Secure Florida Tax Residency for the Seasonal Resident* ©2011 for Health & Wellness Magazine, *The Second Marriage Estate Planning Dilemma* ©2011 for the Naples Daily News, and *My Old Kentucky Home or the Sunshine State? Residency and Estate Planning Issues of Kentucky "Snowbirds" in Florida* ©2010 for the Kentucky Bar Association.

Prior to commencing his law practice, Mr. Eardley was an active duty Naval officer and served as an airborne intelligence officer assigned to a reconnaissance squadron based in Europe. Mr. Eardley is married to Holly, for 25 years, and has five children ages 22 to 8.

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Key Private Bank

Table of contents

Key Private Bank

Introduction

Florida is well-known throughout the United States and the world as a popular tourist and retirement destination. Florida boasts a very mild climate, with only a slight difference between winter and summer temperatures, and coastlines with miles of beautiful beaches, keys and islands, all with year-round water sports. Additionally, Florida has a number of popular tourist attractions, including Disney World and Busch Gardens, and is very taxpayer friendly compared to most other states. For these reasons Florida is becoming increasingly popular as a home for people that used to live in other states or countries. However, perhaps the greatest factor attracting newcomers to Florida is the significant tax benefits for its residents. In fact, an average of nearly 500,000 people per year relocate to Florida and a handful of other states that have limited or no income or death taxation. This handbook will guide the Florida resident, or prospective resident, through many of the important estate planning steps in properly establishing a Florida residency and implementing an effective estate plan.

Article I.

Advantages of Florida residency

No state income tax

First, and perhaps foremost, Florida is one of only seven states in the United States that impose no personal income tax – and it is the only "non-tax" state in the southeastern United States. The other non-tax states are Alaska, Nevada, South Dakota, Texas, Washington and Wyoming.

Florida's no income tax policy is a long-standing part of state taxation philosophy – being first drafted into the State Constitution in 1885. Importantly, to remove Florida's Constitutional ban on a state income tax would require that a Constitutional amendment be enacted – a most unlikely event.

As noted, most states do impose a state income tax, and this tax rate commonly is in the 6% to 8% range – or even higher. For example, at present the marginal state income tax rate for a New York resident is 8.97%. Therefore, by establishing a Florida residency one obtains an "automatic pay raise" just by reason of avoiding the state income tax from his or her state of origin.

Interestingly, Florida is able to raise the majority of its revenue – approximately 70% of the annual budget – solely from the sales tax.

No municipal income tax

Also, the Florida Constitution generally bans municipalities from the levy of a personal income tax. However, many cities in other states do levy personal income taxes. For example, New York City residents are subject to a marginal city income tax rate in excess of 3.5%, in addition to the New York state income tax.

Constitutional homestead property tax cap

Florida also has a long-standing public policy of providing homestead property tax relief stemming from the Great Depression era. For example, in 1934 the Florida Constitution was amended to provide a $5,000 exemption on the assessed value of one's homestead. This exemption, though not keeping pace with the cost of housing, now stands at $50,000.

However, the much more important property tax benefit given to Florida residents is the "Save Our Homes" homestead exemption provided in Article VII of the Florida Constitution. Under this exemption the assessed value of a Florida homestead for property tax purposes may only be increased in any year by the lesser of (i) 3% from the homestead's prior year tax assessment, or (ii) the percentage change in the consumer price index – notwithstanding the actual increase in the market value of the home.

This is not the case with a non-resident's property. The Florida home or vacation property of a non-resident is adjusted annually by up to 10% of its prior year assessment. The result of this resident/non-resident disparity is that the Florida non-resident, over time, often pays thousands of dollars more in property taxes than the next door "Florida" neighbor with a comparable home.

Also, with the present drop in housing values, it is an opportune time to seek residency status and lock in one's homestead Florida property tax assessment base.

No state death tax

Another significant tax benefit afforded to Florida residents is that it levies no death tax. Florida Statutes do contain what is commonly referred to as a "pick-up tax" for estates that owe a federal estate tax liability. Under the federal estate tax system, estates are allowed an off-setting dollar-for-dollar credit for state death taxes paid to a certain amount. Florida law parallels the federal "state tax credit" regime in that it only taxes an estate to the extent that the federal system would permit this off-setting tax credit against any federal estate tax. Therefore, under Florida's "pick-up tax" system an estate's combined federal and state death tax liability is no higher than it would have been if no tax at all was paid to Florida. The only difference is that the death tax is divided between the IRS and Florida.

No intangible personal property tax

Many states impose a tax on the "intangible" assets of its residents – typically assets such as brokerage accounts. Although Florida is known as a tax haven, for a number of years it nevertheless did impose an annual intangible personal property tax (once at a rate of $2,000 in tax for every $1 million in value). Although this tax was modest in comparison to the income taxes of many other states, for years the intangibles tax was a nuisance to those establishing a Florida residency.

Fortunately for taxpayers, the intangibles tax was repealed several years ago – and thus one of the last vestiges of a Florida individual tax has taken the same course as Florida's income and death taxes.

Asset protection

Florida law is very favorable compared with most other states for those concerned with asset protection. Thus, for risk-averse individuals, such as doctors and business entrepreneurs, Florida law provides a favorable environment in which to conduct business with reduced concerns for asset protection from a lawsuit.

Florida homestead protection during life.
Florida homestead law is quite unique compared to most states. Simply stated, the Florida Constitution provides that one's "homestead" is exempt from capture by the vast majority of creditors.

However, it is important to note that not all homes automatically qualify for homestead protection under the Constitution.

First, the owner's state of primary legal residence must be Florida and the Florida home must be the person's primary physical residence. Interestingly, Florida courts have ruled that not just the traditional Spanish-style villa or beachfront condo may be a homestead. For example, Florida courts have even granted homestead status to houseboats and motor homes. However, homestead status is not available if a business entity, such as a family partnership or corporation, owns the property.

Second, the Constitutional protection is limited to a one-half acre if the home is located within a municipality, or to 160 acres if the home is located outside a municipality. Property exceeding the stated parameters generally is unprotected and has produced very interesting results in litigation as to the proper division of the homestead portion of the property from the non-homestead portion.

Third, the owner must have resided in the Florida homestead long enough (generally up to 1,215 days) to be eligible for the maximum creditor protected status under the 2005 Federal Bankruptcy Act. However, if the homestead is owned jointly by spouses, there should be no waiting period. Such joint ownership protection is discussed below in more detail.

Also, it is important to note that homestead protection is not limited to United States citizens, but is available to any person whose primary residence is in Florida. Thus, risk-wary individuals from Europe and elsewhere can avail themselves of Florida's generous homestead creditor protection.

Florida homestead protection after death.
Florida homestead protection from creditors often continues after the owner's death. Specifically, the Florida Constitution provides that the benefit of creditor protection passes to one's spouse or relatives if they are the beneficiaries of the homestead. Importantly, Florida Courts have broadly interpreted the term "relatives" to include not only one's spouse, children and grandchildren, but also cousins of several degrees removed, nieces and nephews and their descendants, and even more distant relatives.

Marital joint property.
Florida real estate and investment accounts jointly owned by spouses generally are presumed to be owned by the spouses in a marital status known as "tenants by the entireties." Importantly, Florida property which is owned in this status cannot be captured by the general creditors of just the husband or the wife. For creditors to capture the property, both the husband and the wife must be indebted to the creditor. Very importantly, this status even trumps creditor rights afforded by the 2005 Federal Bankruptcy Act.

Article II.

Establishing a Florida residency

Obtaining the various tax and other benefits by reason of Florida residency is fairly straight-forward for a person whose only home is in Florida. However, the matter becomes complicated and calls for careful attention for a person who maintains a home in Florida and a home elsewhere.

The primary concern for the individual in this situation is to take all steps possible to avoid any claim by the taxing authority in the state of origin that one's income and/or estate continue to remain subject to taxation in that state because of residency. More and more people are relocating from northern states, especially from those with high tax burdens, to Florida – with the result to those states being the loss of significant tax revenue. And this has not gone unnoticed by those states. In fact, a recent article in the *Wall Street Journal* reported that Massachusetts had established a special "Domicile Unit" within its Department of Revenue to audit persons who claim non-residency but still maintain a significant connection to Massachusetts.

There are a number of recommendations that, in most cases, should be implemented to establish a Florida "domicile" and, with that, obtain the important tax benefits that accompany this status. However, it is imperative in each case that competent legal counsel both in Florida and the state of origin be used to guide this process.

The words “residence” and “domicile” are both used above interchangeably. However, for legal purposes, the terms “residence” and “domicile” have very distinct meanings. “Residence” means a place where one possesses a dwelling. This can be, and often is, more than one place. “Domicile,” however, means the residence which is a person’s primary home. And it is having a Florida “primary home” or domicile that triggers the various tax and other benefits.

Thus, when a person has one residence in Florida and another in the state or country of origin, it is critical to obtaining Florida’s tax benefits that he or she establish the Florida residence as the “domicile.” However, because it is common to use the word “residence” but actually mean “domicile,” the remainder of this material will use the term “residence” or “resident” but only in the “domicile” sense.

Article III.

A “check-list” to Florida residency

As a practical matter, Florida does not put obstacles in the way of a person desiring to become a Florida resident, provided he or she goes through the various governmental “hoops” to establish residency. However, for the person who will continue to maintain a home in another state, the critical matter is to convince the taxing authorities of the other state that Florida is now the state of primary residence.

Having Florida as one’s primary residence, for “northern” state tax purposes, is essentially a matter of qualifying as a non-resident of the northern state under that state’s non-residency tax law. Many northern states utilize an annual “day-counting” test, with regard to the number of days a person spends in the northern state, to make the residency determination.

However, even if the “day-counting” test is avoided, many northern states employ a back-up “residency intent” test that must also be avoided. And since the northern state cannot examine a person’s mental intent for residency, objective factors are evaluated by the northern state to determine the person’s residency intent. Along these lines, there are a number of steps to take that are useful for proving one’s Florida residency intent. These steps, which are discussed below, are generally applicable to most northern states but are not exhaustive nor intended to substitute for tax counsel.

Step 1
Obtain a Florida Driver’s License.
A person should obtain a Florida driver’s license. Florida law currently requires that new residents obtain a driver’s license within 30 days of establishing Florida residency. A driver’s license can be obtained at the local office of the Division of Driver’s Licenses. Importantly, a person with a driver’s license from another state may obtain a Florida license without a written road test—only a vision test is required. The license of the state of origin must be surrendered at the time of application for the license. However, the Division of Driver’s Licenses does offer a “valid in Florida only” license to seasonal residents who wish to maintain their out of state licenses, nevertheless, this type of license should be declined by anyone claiming Florida residency status.

Step 2
Register to Vote.
A person should register to vote in Florida and concurrently send a letter to the Supervisor of Elections in the former county of residence requesting removal from the election roster. For convenience, Florida allows a person obtaining new driver’s license to register to vote with the application for the new driver’s license.

Step 3
Apply for the Homestead Exemption.
If real estate is owned, a Homestead Exemption application should be filed with the county Property Appraiser’s office. Interestingly, although the Homestead Exemption is necessary to obtain the “Save Our Homes” property tax cap discussed above, it is not determinative with regard to homestead creditor protection. That is, one can fail to have filed for the Homestead Exemption but still potentially have the property considered homestead for creditor protection purposes.

To file a Homestead Exemption all that is required is proof of one’s ownership of a Florida residence (such as a Deed or tax bill), a Florida driver’s license, a Florida automobile registration, a Florida voter registration card and all owners’ social security numbers. To qualify for the Homestead Exemption for a particular year, all of the foregoing documents or instruments must be dated on or before December 31st of the prior year and filed by March 1st of the present year.

Additionally, if the residence is held in a trust, the Property Appraiser’s office will require a copy of the trust and, if the “homesteader” is not a U.S. citizen, the person’s green card will be required.

As noted above, with a Homestead Exemption the 3% annual cap applies to property assessment increases and, as well, provides the owner a $50,000 reduction from the assessed taxable value of the homestead.

If the application deadline is missed, appeal can be made to the Value

Adjustment Board, with just reason for failing to make a timely application for the Homestead Exemption.

Step 4
File a declaration of domicile.
Another document which is important to file to prove Florida residency is the Declaration of Domicile. This is an official government document by which the person states under oath that he or she is a primary resident of Florida and recites his or her Florida address. The Declaration is then recorded with the Clerk of Court for the county of residence. The original Declaration, upon recording with the county Clerk of Courts, is then returned to the applicant.

It is recommended that a copy of the filed Declaration of Domicile be sent to the taxing authority of the state of origin with a written explanation of the new residency status. This may be done concurrently with the taxpayer's filing of his or her final resident income tax return for the state of origin.

The main purpose of the Declaration of Domicile is to evidence one's current intent to be a Florida resident – especially from the perspective of a tax auditor from one's state of origin. A Declaration of Domicile can be obtained on the websites of most counties or from the county Clerk of Courts.

Step 5
Update the estate plan for compliance with Florida law.
Another important step to establishing Florida residency is to have one's estate planning documents prepared or updated for compliance with Florida law and to reflect Florida as the state of residence. Each state has unique rules pertaining to the estate planning documents (such as the Will, Trust or Power of Attorney) of its residents – and these rules vary somewhat from state to state. Therefore, a person who intends to be a resident of Florida would naturally seek to have a valid Florida estate plan.

Interestingly, a survey of the information available from a number of northeastern state tax revenue department websites will reveal that many of these states provide their auditors with a checklist to follow to determine if a person who is claiming to be a non-resident of the northern state should instead be considered a resident. Several of these checklists ask the troubling question "In what county and state does the person's Will indicate he or she is a resident of?"

Also, since Florida has its own special rules pertaining to estate planning documents, it is very important, regardless of any state tax concerns, to have all estate planning documents made compliant with Florida law to ensure that one's testamentary wishes are carried out. For example, under the Florida Statutes the Executor of one's estate must be a (i) close relative, (ii) Florida resident, or (iii) Florida bank or trust company, such as KeyBank. Thus, a close and trusted family friend residing outside of Florida cannot be a Florida Executor. Many would not be aware of this issue unless Florida counsel was consulted.

Step 6
Focus main activities and affiliations in Florida.
Additionally, it is prudent to restructure one's activities, relationships and affairs to comport with a bona fide Florida residence. This would include spending a majority of one's time in Florida and relocating important relationships and matters such as one's investment management firm, banking relationships, CPA, social and religious affiliations, safe deposit box, billing addresses, heirlooms, etc., to Florida.

As noted above, some states have guidelines or checklists which direct a tax auditor to explore a number of these factors to determine where the taxpayer's "real" residence is. Thus, it is advisable to structure all of one's activities and affairs in a manner such that an independent observer would conclude that one's primary home is Florida.

Step 7
Obtain a written, non-resident tax opinion from tax counsel in the state of origin.
Although many of the steps to securing a non-residency status are similar from state to state, it is imperative for the person who will maintain an ongoing presence in a state that imposes an income and/or death tax to obtain a written tax opinion from a qualified tax attorney or CPA from that state identifying what specific steps must be taken to be recognized as a non-resident by the taxing authorities of the state of origin. Each state has its own, unique tax residency rules and one's state of origin is not bound by a claim of Florida residency unless all applicable residency laws and regulations promulgated by the state of origin are avoided – and the only way to know these laws with certainty, and avoid them, is by use of qualified tax counsel from that state.

Article IV.

Florida estate planning issues

Generally speaking, estate planning can be divided into three parts. The first part is the implementation of legal documents to carry out the client's

various testamentary wishes, such as who is to inherit estate property. The second part is saving estate taxes by implementing appropriate estate planning techniques. And the third part is to ensure that the client's assets are postured so that each asset will actually pass at death in the manner that the client desires. In these respects, estate planning for the Florida resident does not vary significantly from that of residents of other states. However, Florida does have several Constitutional or statutory peculiarities that must be addressed.

Estate planning documents

A complete Florida estate plan typically consists of at least 3 components: (i) a testamentary documentary (a Will and/or Trust), (ii) a Durable General Power of Attorney, and (iii) an Advance Directive for health care.

The Testamentary Document.

A testamentary document is the legal instrument utilized to identify the heirs of one's property and to designate who will have responsibility for handling all estate and legal affairs at death.

The Last Will and Testament.

Historically the testamentary document of choice to state one's terminal instructions was the Will – and the Will still is used frequently by Florida attorneys for smaller estates or for younger persons.

A common misconception is that a Will signed in a prior state is no longer valid once the person becomes a Florida resident. Fortunately, this is not the case. Under Florida Statute 732.502, a Will executed by a person in another state, while a resident of that state, remains valid in Florida once the person becomes a Florida resident.

However, it is important to note one critical caveat – even though the out-of-state Will itself is valid in Florida, this does not mean that all the terms of the Will are valid in Florida. This is discussed in more detail below. For this reason, among others, it is crucial that a new Florida resident have his or her Will updated for compliance with Florida law.

The Revocable or Living Trust.

In recent years the testamentary document of choice for many, in lieu of the Will, has been the Revocable or Living Trust (hereafter a "Revocable Living Trust" or an "RLT"). As with a Will, a Revocable Living Trust executed by a person in another state, while a resident of that state, remains valid in Florida once the person becomes a Florida resident. However, all of the terms and provisions of the RLT may not remain valid under Florida law. This issue is discussed in more detail below.

Overview of the Revocable Living Trust.

A Revocable Living Trust is a common estate planning recommendation for a client (sometimes referred to as the "settlor" or the "grantor") who wishes to obtain important benefits that a Will cannot provide. From an estate planning standpoint, the RLT is also utilized in lieu of a Will to implement the client's testamentary wishes. During the past 20 to 30 years, RLTs have gained popularity as a sound device for accomplishing a number of legitimate estate planning goals.

Avoiding Probate.

Probate is the court-supervised legal process of transferring a deceased person's property to his or her heirs. An RLT will avoid the costs and delays of a court probate at the client's death. The ability to avoid a court probate at death generally is the most valuable feature of an RLT.

Most people wish for their estates to avoid probate because this process can be relatively expensive, time-consuming and inconvenient. Generally speaking, the probate process is expensive and prolonged due to the need for increased attorney involvement and by statutorily mandated probate procedures. Further, the probate process often produces a significant delay in the actual receipt of estate assets by the heirs. Also, if a person owns real estate outside of Florida, it is particularly important to transfer such real estate to the RLT to avoid a probate in that other state.

Mental Incapacity.

An often overlooked benefit of the RLT is the ability to minimize the likelihood of a court-supervised guardianship in the event of mental incapacity. Upon the settlor becoming mentally incapacitated, his or her designee becomes the trustee of the RLT. Often the designee is a spouse or child of the settlor, or the settlor's bank or investment firm, such as KeyBank. The settlor's chosen designee, as "successor trustee," then has authority to invest and manage the RLT assets according to the settlor's wishes as set forth in the RLT document. The RLT typically provides that the assets are to be prudently invested and paid out for the settlor's health care and support for the remainder of the settlor's life.

Parties to the Trust.

In the typical arrangement, the settlor who creates the RLT will also be named as the initial trustee of the RLT. He or she is often the sole beneficiary of the trust during his or her life. Upon the settlor's death, the trust then becomes irrevocable, like a Will, and the person or institution named in the RLT as the successor trustee then becomes the acting trustee. Often a bank or

corporate trust company, such as KeyBank, is named as the successor trustee to ensure that an orderly and professional trust administration is conducted.

As with a Will, the RLT provides for the disposition of the deceased's property at death to the intended heirs. The successor trustee is the party who is charged with the responsibility of distributing or holding the trust property according to the terms of the RLT document.

Power to Revoke or Amend the RLT.
The typical RLT provides that during the settlor's lifetime he or she may amend or revoke the trust at any time and, as well, take possession of any trust property.

Funding the Trust.
For the RLT to be effective in avoiding probate, it is necessary that all property that would otherwise be subject to probate be legally titled into the RLT prior to death. Any property that has not been transferred into the RLT before death generally will be subject to probate. Thus, a crucial element of implementing the RLT is the "follow through" work of transferring assets to the RLT once the trust document is executed.

Funding the RLT involves transferring legal title of the assets from the settlor to the RLT. For example, if John Smith is funding his RLT, he will work with his investment firm to change title to his accounts from his individual name to "John Smith, Trustee, John Smith Revocable Living Trust dated 1/1/2011."

Specific legal issues pertain to the transfer of certain types of property to the RLT, such as life insurance and homestead property, and therefore it is imperative to consult with a Florida attorney to develop an appropriate "funding plan" before actually transferring property to your trust.

Estate and Income Taxes.
A common misconception is than an RLT saves estate taxes. The RLT will not minimize estate taxes at death unless it contains appropriate tax reduction provisions. However, estate taxes can also be minimized by a properly drawn Will.

During the settlor's lifetime, an RLT does not produce any income tax consequences. For federal income tax purposes, the RLT is treated as if it did not exist. Instead, all income and loss of RLT assets is simply reported on the settlor's personal tax return. Also, any account opened for the RLT can utilize the settlor's social security number.

Asset Protection.
Although many people believe that an RLT shields their assets from creditors, this is not correct. However, there are other trust and estate planning devices that can provide creditor protection.

Invalid Provisions in a Florida Resident's Will or Revocable Living Trust.
As noted above, although a Will or RLT made in another state remains valid in Florida once the person becomes a Florida resident, not all of the terms and provisions of the Will or RLT necessarily remain valid under Florida law. For this reason, it is critical that a new Florida resident promptly have his or her Will or RLT updated for compliance with Florida law. Some of the more common provisions at issue with a non-Florida Will or RLT are discussed below:

Executor Provisions.
The Will is the document that, among other matters, nominates the Executor of one's estate. The Executor is the person or entity charged with collecting the deceased's property and distributing it in accordance with the terms of the Will. In Florida the technical designation for this role is the "Personal Representative." For many, the Personal Representative designation is one of the most important provisions of the Will.

However, Florida law generally limits who may be a Personal Representative to (i) a Florida resident, (ii) a close relative, or (iii) a Florida bank or trust company, such as KeyBank. Stated another way, a friend who does not live in Florida cannot be the Personal Representative of a Florida estate. Thus, a person who relocates to Florida may bring with him or her a valid Will but an invalid Personal Representative designation.

Importantly, KeyBank is one of just a handful of Florida banks that has as a cornerstone of its business history and model a primary emphasis on providing professional Personal Representative services to its clients.

Penalty Provisions.
In many states an "in terrorem" (from the Latin for "in fear") or penalty clause may be inserted into a Will or RLT. This type of provision states that if a beneficiary attempts to challenge the Will or RLT, then that beneficiary will forfeit his or her inheritance. A penalty clause may be particularly important to a person who anticipates that strife will occur between heirs unless a significant price is to be paid by the contentious heir. However, under Florida Statutes a penalty clause is "illegal" and thus such a provision in the Will or RLT of a Florida resident will not be recognized by a Court.

Guardianship Provisions.
One's Will also nominates the Guardian for any minor children. For many,

the Guardianship provision is a very important part of the Will. However, Florida law limits who may be a Guardian for a minor child to either a Florida resident or a close relative of the child. Unfortunately, this means that a close and trusted friend who does not live in Florida cannot serve as the Guardian for a Florida minor.

Homestead Issues.
Florida law has traditionally been very protective of the homestead in a number of ways—and this protective inclination extends to the transfer of the homestead at death.

Once a person becomes a Florida resident, his or her home then becomes the "homestead" for testamentary purposes. And, interestingly, this is the case whether or not the person has actually filed for the homestead property tax exemption.

Under Florida law, if the homestead is not jointly owned by spouses with right of survivorship, then it may only be bequeathed outright to the surviving spouse. Any other bequest of the homestead is statutorily invalid. Also, if the deceased has one or more minor children, then even a bequest of the homestead to the surviving spouse is statutorily invalid. Instead, in both situations the ownership of the homestead, upon the death of the spouse who owns the homestead, is automatically divided, by statute, into a split ownership arrangement.

Specifically, when the spouse who is the home-owner dies, the surviving spouse becomes the legal owner of a "life estate" in the home, but with the deceased spouse's children entitled to possession and full ownership upon the surviving spouse's later death.

The "life estate" right permits the surviving spouse to use the home rent-free for the remainder of his or her life. Of note, the surviving spouse is not precluded from using the home as a rental property or from co-habiting there with others.

Alternatively, the surviving spouse instead may elect to take a 50% ownership interest in the home. In this case, the deceased spouse's children become owners of the other 50%.

In any event, both the life estate and 50% ownership situations present unsettling difficulties. For example, upon a sale of the home, all owners (the surviving spouse and the deceased spouse's children) must consent to the sale and, as well, all parties are entitled to a share of the proceeds.

Unfortunately, many individuals do not recognize the potential for this situation and the post-death split ownership arrangement is not an infrequent occurrence.

The author recently learned of the case of an elderly woman who had settled in Florida with her husband of more than 50 years, a retired physician. They purchased a beautiful beachfront condo but allowed their long-standing Massachusetts attorney to prepare their new Florida estate plan – even though they had become Florida residents. Upon the advice of the Massachusetts attorney, who was unaware of Florida's unique homestead rule, the wife retained sole ownership of the beachfront condo until her death. As a result of his wife's passing, the retired physician became the co-owner of the beachfront condo with his 6 children. Not exactly the result this senior couple was seeking – and completely avoidable with proper planning.

Other Invalidity Issues.
The above comments are not a comprehensive listing of all of the Will or RLT provisions and issues that must be considered upon establishing a Florida residency, but are merely a sampling of some of the more common ones that cross the desk of the Florida estate planning attorney. As with any matter of legal import, upon becoming a Florida resident the new resident should retain qualified Florida legal counsel to guide him or her in the process of implementing an appropriate Florida estate plan.

The Durable General Power of Attorney.
Having one or more Florida Durable General Powers of Attorney in effect is another crucial element of a complete Florida estate plan. A Power of Attorney instrument is a document by which one person (the "Principal") appoints another person or entity (the "Attorney-in-Fact") to act on his or her behalf.

The proper Power of Attorney instrument is "Durable" – which means that the authority granted to the Attorney-in-Fact remains in effect for the remainder of the Principal's lifetime, unless the Principal revokes the Power of Attorney instrument. Also, the Power of Attorney is statutorily suspended in certain situations, such as upon the initiation of a judicial proceeding to determine the Principal's mental capacity.

Further, the appropriate type of Power of Attorney instrument is a "General" Power of Attorney. It is designated as such because it grants the Attorney-in-Fact the authority to act "generally" for the Principal.

Importantly, the Durable General Power of Attorney instrument is most useful for the Principal who is in his or her

senior years and thus may not be able to properly attend to important financial matters, such as the payment of bills. With the Durable General Power of Attorney in hand, the Attorney-in-Fact can legally handle all such matters.

Customarily a Principal will appoint several Attorneys-in-Fact so that if one of the Attorneys-in-Fact dies or is otherwise unavailable, the other Attorney-in-Fact can assist the Principal. Most commonly, the Principal designates as Attorneys-in-Fact the Principal's spouse, if any, and one or more adult children.

As noted above, many estate planning instruments prepared in other states remain valid after one moves to Florida. However, there is ambiguity in this regard concerning certain authorities granted in the Durable General Power of Attorney – due to the enactment of Florida's new Durable General Power of Attorney Statute on October 1, 2011. Therefore, it is advisable that updated Durable General Powers of Attorney compliant with Florida Statutes be implemented upon moving to Florida.

The Advance Directive for Health Care.

Most states have enacted statutes pertaining to "end of life" health care decisions and the appointment of the persons who will make health care decisions for the ill person (referred to as the "Principal" under Florida Statutes). Often such written instruments are referred to generally by terms such as "Living Will" or "Health Care Surrogate."

Florida Statutes provide that an "Advance Directive" is a written statement by the Principal, with proper witness and notary execution, which pertains to any aspect of the Principal's health care. Florida Statutes further specify that a "Living Will" is a written statement, again with proper witness and notary execution, concerning "life-prolonging procedures."

As part of a complete estate plan, a Florida resident is well-advised to implement a health care instrument compliant with Florida Statutes. In practice, many Florida attorneys draft the client's Advance Directive and Living Will as a single document since both documents intersect in important ways. Often such a document is styled as an *Advance Directive for Health Care,* or simply, an *Advance Directive*.

The Advance Directive addresses several critical matters. First, the Advance Directive directs who will make health care decisions for the Principal if the Principal becomes mentally incapacitated. This decision-maker is referred to in Florida Statutes as the health care "Surrogate." Most commonly the Principal designates as Surrogate the Principal's spouse, if any, and then one or more adult children as the alternate Surrogates.

Second, by the Advance Directive the Principal directs what is to be done if the Principal experiences a medical condition that requires "life-prolonging procedures" to continue his or her life – when the Principal is mentally incapacitated and in a condition from which recovery is medically improbable. Florida Statutes provide that "life-prolonging procedures" include life-support functions, such as artificial respiration and a feeding tube.

If one has not executed an Advance Directive, then the decision to continue or to remove life-support is held by the Principal's statutorily-designated "proxy." The general statutory sequence for the proxy appointment is first the spouse, then one's adult children, then one's parents, then one's siblings, and finally a "close friend" (as determined in an affidavit from the "close friend").

However, the statutory proxy (even if it is the spouse) may not have life-support removed unless it is shown by "clear and convincing evidence" – a very high evidentiary standard – that removal would have been the patient's desire. Consequently, if there is any substantial evidence that the patient desired life-support, then life-support may not be removed.

Further, if there is no evidence regarding the patient's life-support desire, then life support may only be removed if removal is deemed to be in the patient's "best interest." Unfortunately, Florida statutes do not define what one's "best interest" is – leaving open the possibility of another Terri Schiavo situation.

Also, as with a Will or RLT, an Advance Directive executed by a person who was a resident of another state who later relocates to Florida remains valid in Florida. Nevertheless, it is advisable that upon relocating to Florida to prepare a new Advance Directive compliant with Florida Statutes. The Florida Advance Directive Statutes utilize specific medical terminology which is unique to Florida, and thus it is prudent for the new Florida resident to have an Advance Directive that tracks the format and terminology to which the medical personnel in Florida are accustomed and understand.

Furthermore, health care privacy rules were tightened several years ago under the federal Health Insurance Portability and Accountability Act or "HIPAA." HIPAA provides stiff monetary fines and criminal penalties, including felony level convictions, for the disclosure of patient medical information to a third party unless the patient has granted permission for the medical information to

be released. A properly drawn Advance Directive will incorporate the HIPAA requirements and grant the Principal's health care Surrogate authority to access all medical information.

Spousal Inheritance Rights.
Nearly every state in the United States grants a surviving spouse the right to inherit a portion of the deceased spouse's estate regardless of the terms of the deceased spouse's Will or RLT – and Florida is no exception. Although such "spousal rights" are fairly similar from state to state, Florida Statutes Chapter 732 provide a comprehensive and specific set of rules and benefits that apply with regard to a surviving spouse of a person who dies while a Florida resident. The philosophy behind spousal rights laws is that a spouse should not have the right to unilaterally disinherit his or her spouse – potentially leaving the surviving spouse penniless and a ward of the state or federal government. Nevertheless, a spouse may legally waive his or her rights by use of either a prenuptial or a postnuptial agreement.

Specific Spousal Inheritance Rights.

Florida Statutes provide a surviving spouse two main rights.

First, if the surviving spouse is not a joint owner of the homestead, then upon the death of the spouse who owns the homestead the property is automatically divided by Florida Statutes into a split ownership arrangement. Specifically, the surviving spouse becomes the legal owner of a "life estate" in the home, but with the deceased spouse's children entitled to possession and full ownership upon the surviving spouse's later death.
The "life estate" right permits the surviving spouse to use the home rent-free for the remainder of his or her life, subject to payment the expenses and debts associated with the homestead. This life estate "automatically" passes to the surviving spouse if he or she is not designated in the estate plan as the sole beneficiary of the homestead. However, court action will eventually become necessary to demonstrate that the surviving spouse actually is the title owner of a life estate interest in the homestead – such as when there is a desire to sell the homestead.

Alternatively, the surviving spouse may elect a 50% ownership interest in the home. In this case, the deceased spouse's children become owners of the other 50%.

Second, a surviving spouse is entitled to an "Elective Share" of the deceased spouse's "Elective Estate." Although the assets which are included in the Elective Estate are delineated with great specificity under Florida Statutes Chapter 732, generally speaking, the Elective Estate includes almost every asset that the deceased spouse owned. The surviving spouse is entitled to property equal in value to 30% of the Elective Estate – and this 30% share is designated as the Elective Share.
To claim the Elective Share, the surviving spouse must affirmatively follow the required statutory procedure within a set timeframe. If not, then the Elective Share may be forfeited.

Of course, often the surviving spouse is a primary beneficiary of the deceased spouse's estate, and thus a surviving spouse's above interests become moot.

Waiver of Spousal Inheritance Rights.
In second marriages it is not uncommon that each spouse has sufficient assets, independent of the other spouse, and desires that his or her entire estate to pass to his or her own children. Therefore, the spousal inheritance rights discussed above seemingly could circumvent each spouse's very natural wishes.

To accommodate such situations, Florida law permits persons, either before or after marriage, to waive some or all of their spousal inheritance rights.

The waiver of spousal inheritance rights before the marriage is implemented by a "premarital" agreement and the waiver of spousal rights after the persons have married is implemented by a "postmarital" agreement.

Although a complete discussion of such agreements is beyond the scope of this material, it is crucial to note that very strict rules apply with regard to the implementation of valid and enforceable premarital and postmarital agreements, and thus these agreements should only be entered into with the utilization of qualified Florida legal counsel.

Article V.

The federal estate, gift and generation skipping transfer taxes

The federal death tax regime traces its roots to the World War I era and the Revenue Act of 1916. The purpose of the 1916 Act was not so much to generate revenue as it was to dissipate larger estates that were being passed from one generation to the next. Interestingly, in 1916 the amount exempt from the tax was $50,000 and the marginal tax rate was only 10%. It is estimated that the $50,000 exemption in 1916 dollars would be worth more than $10 million as of the time of this writing. As time progressed, the tax rate began to rise and in 1924 the federal gift

tax was introduced. By the late 1940s the maximum estate and gift tax rates ballooned to 77% and, by the arrival of the country's bicentennial in 1976, the estate and gift tax regimes became an integrated tax system.

In the early 1980s Congress began to reduce the estate tax burden, decreasing the marginal tax rate from 70% to 50% and setting the exempt amount at $600,000 per person. And in 1986 the modern Generation Skipping Transfer Tax (or "GST" tax) system was enacted by Congress. Prior to the enactment of the GST tax, people had been able to gift or bequest property to their grandchildren – skipping altogether the expected gift or estate tax imposition at the child's level. However, Congress closed this "loop-hole" with the enactment of the GST tax system – which imposes a second "death tax" liability for gifts or bequests to beneficiaries 2 or more generations removed from the taxpayer.

In 1997 Congress implemented phased-in annual increases to the $600,000 estate tax exemption, and in 2001 Congress passed the Economic Growth and Tax Relief Reconciliation Act (sometimes referred to as "EGTRRA"). EGTRRA provided for parallel, scheduled increases in the estate and GST tax exemption amounts and decreases in their marginal tax rates over the next 8 years, with the estate tax and GST tax exemptions capping out at $3.5 million apiece in 2009. Also, under EGTRRA the estate and GST tax regimes were inapplicable to deaths occurring in 2010 and the estate, gift and GST tax regimes were scheduled to revert a to their pre-EGTRRA amounts of $1 million each.

Not surprisingly, the 2010 estate tax "holiday" resulted in what some characterize as an unfair financial boon for families of wealthy individuals who died in 2010. Most notable among this group was Dan Duncan, a natural gas tycoon from Houston, who died of a brain hemorrhage in at age 77. *Forbes* magazine estimated Duncan's net worth at $9 billion – making him the 74th wealthiest person in the world.

In any event, an interim of estate tax certainty and relief was obtained in late 2010 when President Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. The 2010 Act set the estate and gift tax exemptions at $5 million for 2011 and 2012, and lowered the top tax rate to 35%. Also, the Act set the GST tax exemption at $5 million through 2012.

Interestingly, the 2010 Act also enacted a "portability" feature for married couples experiencing a spouse's death in 2011 or 2012. Portability allows the surviving spouse to use the deceased spouse's unused estate tax exemption, at the surviving spouse's later death, without the implementation of more complicated trust planning at the death of the first spouse to die. However, the enactment of portability did not necessarily reduce the costs of estate planning. To actually utilize the portability feature, the surviving spouse must file a federal estate tax return for the deceased spouse – even if a return is not otherwise required – and affirmatively elect portability. Also, as of this writing, the portability feature expires in 2013, and therefore it is only usable if the surviving spouse also dies before the end of 2012.

Like EGTRRA, the 2010 Act is scheduled to expire on January 1, 2013. On that date the estate, gift and GST tax exemptions will revert to the pre-2001 Act level of $1 million – unless Congress takes remedial action.
As of this writing, there is sparse information and discussion in the tax professional community regarding the future of the estate tax. It is the author's belief that this is because there have been, and continue to be, a number of particularly urgent political issues on the front-burner – such as the battle over the national debt and the presidential campaigns – which have had the attention of lawmakers and the national media.

However, a possible insight into post-2012 estate tax law is found in the Treasury Department's fiscal year 2012 Revenue Proposals issued in the first half of 2011. Although Treasury's Revenue Proposals are more akin to a "wish-list" rather than something set in stone, the Proposals assume that the 2009 estate and gift tax levels (with the $3.5 million exemptions and the 45% tax rates) will be made permanent when the 2010 Act expires on January 1, 2013. And even though the exemption amounts and tax rates in the Revenue Proposals are not as generous as many may hope, this may been seen as a positive sign that the Obama administration and Democratic lawmakers may be supportive of legislation to avoid the scheduled return of the $1 million exemption.

Further, though the 2010 Act does not offer long-term tax planning certainty, for individuals desirous of pro-active tax reduction planning, the current $5 million exemption may present a closing window of time in which to transfer significant wealth to the next generation free of estate and gift tax consequences.

Article VI.

Panning techniques to reduce estate, gift and GST taxes

Although the estate, gift and GST taxes can produce enormous tax liability, proper estate planning can serve to greatly reduce or eliminate the amount of these taxes as well as to significantly postpone these tax liabilities. The following are some of the more common planning techniques that are available to achieve these goals:

Fully utilize the estate tax exemption

Although there is much uncertainty regarding what the post-2012 estate tax exemption will be, it is nevertheless critical to ensure that one's exemption is fully utilized. While this is not difficult for the single person, for a married couple it is of great importance to create an estate plan that will capture both spouses' estate tax exemptions.

Many "simple" Wills or RLTs for married couples provide that the estate of the spouse that dies first passes entirely to the surviving spouse. Fortunately, no estate tax is imposed at that point regardless of how large the deceased spouse's estate was (provided that the surviving spouse is a U.S. citizen) by reason of the unlimited estate tax marital deduction. However, such a "simple" plan has the effect of wasting the first to die spouse's exemption. This is because the deceased spouse's entire estate will be owned by the surviving spouse and, upon the survivor's later death, he or she will only have 1 exemption available but will "own" the estates of 2 people.

To address this concern it is recommended that an estate plan be implemented which places the first to die spouse's exemption amount, at death, in a trust for the benefit of the surviving spouse. If the trust is properly drafted, the surviving spouse may be both the sole Trustee and the sole beneficiary of the trust (often referred to as a "Family Trust"), and the Family Trust can last for the remainder of that spouse's life. Importantly, the IRS does not consider the assets in the Family Trust to be owned by the surviving spouse, for estate tax purposes, at his or her later death. The result is that the surviving spouse, in the eyes of the IRS, only owns 1 person's estate (his or her own) at death. Also, because the Family Trust utilized the first to die spouse's exemption, the Trust assets (including all appreciation thereon) pass at the surviving spouse's death completely free of any estate tax – to the couple's children or other heirs.

Also, in lieu of the surviving spouse serving as the sole Trustee of the Family Trust, it is often advantageous to have a bank or trust company, such as KeyBank (often referred to by lawyers as a "corporate fiduciary"), serve a co-Trustee with the surviving spouse, or, alternatively, as the sole Trustee. A corporate fiduciary provides a number of important services that may not be met by an individual Trustee. The corporate fiduciary, in addition to ensuring that all ongoing legal and tax matters are handled properly, such as the preparation and filing of the Family Trust's federal income tax returns and annual beneficiary accounting, also serves to ensure that the Family Trust assets are invested in accordance with accepted professional standards and that the distribution and investment provisions set forth in the Trust are followed precisely and without partiality.

One common concern is that an elderly widow or widower, as a sole Trustee, may come under the influence of an outside party and either disburse Family Trust funds to that party or invest Family Trust funds with the outside party in an imprudent manner. Another common concern in a second marriage situation is that the surviving spouse may not invest or administer the Family Trust with sufficient impartiality for the deceased spouse's children. Such issues are eliminated when a corporate fiduciary, such as KeyBank, serves as the sole or co-Trustee of the Family Trust.

In any event, the Family Trust technique is essential estate planning for a married couple whose combined net worth significantly exceeds the estate tax exemption.

Discounting techniques

To enhance the value of one's estate tax exemption it is often desirable to own "discounted" assets at death. A "discounted" asset is an asset which is reported to the IRS at a value which does not represent its "true" value, in terms of what the asset is worth to the client, but rather what its fair market value is on the open market. The discounted asset is then often used to "superfund" the Family Trust, in the case of a deceased spouse, or simply to reduce the overall estate tax liability, in the case of a single person.

Common examples of discounted assets are fractional or percentage interests in real estate and family limited partnerships. A fractionalized real estate posture, for example, would exist if a husband and wife each owned their Florida home as separate (non-joint) 50% owners. Under the IRS's fair market value reporting requirement, a 50% separate interest in real estate is not reported at one-half of the full value of 100% of the property. This is because a bona fide and independent

buyer would pay less for a 50% interest since the buyer would have to share the property with a co-owner.

Fractional Interest Discounts.
Although fractional interest discounts vary somewhat, a typical discount for real estate is 15% off full market value. Thus, assuming a couple's home is worth $3 million (and disregarding any mortgages), by dividing the property between the husband and wife, as separate 50% owners, they can automatically decrease the value reportable to the IRS at death from $3 million to approximately $2.55 million – even though a post-death sale of home would bring $3 million.

FLP Discounts.
A Family Limited Partnership or FLP is a business entity created and owned by family members and which typically holds marketable securities and real estate. An FLP is often recommended for its many benefits, such as a device for family members to consolidate assets for enhanced investment opportunities and to obtain asset protection. The FLP, if properly structured and administered, can also have the added benefit of being subject to IRS discounts which may exceed 40%.

An FLP is subject to discounting similar to that as fractionalized real estate, as discussed above, except that the discounts applicable to it are for (i) lack of marketability (since the FLP is not publicly traded on an exchange), and (2) minority interest ownership (for the limited partnership portion—which is typically 99% of the ownership status).

As with the fractional interest in real estate opportunity, the use of an FLP also saves taxes, but generally to a heightened degree. For example, assume that the Smith family creates an FLP and transfers $5.05 million in marketable securities and real estate to the FLP in exchange for a 99% limited partnership interest for Mrs. Smith and with Smith adult children owning 1% as the general partners (via a corporate holding entity). Upon Mrs. Smith's death one would think that her 99% interest in the FLP would be reported and taxed at approximately $5 million—the proportionate value of the underlying marketable securities. However, if a 40% discount is obtained, the value reported to the IRS would actually be $3 million.

However, it is important to be aware that FLPs are presently the subject of IRS scrutiny, and an FLP must be administered with all the protocol typically associated with a business entity. Nevertheless, the seemingly "worst case" scenario may be that the FLP is valued by the IRS at the value of the FLP's underlying assets – which would have been the case had the FLP never been created. In this situation one is no worse off than if the FLP had not been created in the first place.

Maximize low tax and leverage lifetime gifting techniques

In addition to the techniques discussed above, it is very important to consider transferring assets out of one's estate during life at either a no tax cost or at a greatly reduced tax cost, and place the assets in the hands of (or Trusts for) the intended heirs. Such techniques serve as a supplement to the use of one's estate tax exemption.

The Zeroed-Out GRAT:
The Grantor Retained Annuity Trust (or "GRAT") is a trust arrangement sanctioned by the Internal Revenue Code and is an ideal "no tax" cost gifting technique. Under the GRAT technique, a client transfers assets (usually a specific class of portfolio assets) into a trust (the "GRAT") and retains predetermined annual annuity payments from the GRAT for at least 2 years. Upon the expiration of the 2 years, the balance (the remainder) of the GRAT assets pass to the client's heirs. The annuity payments back to the client are not considered gifts and only the remainder component constitutes a gift reportable to the IRS. Importantly, however, the annuity payment is structured at a high enough amount so that the remainder component has a near 0 value for gift tax purposes – hence the term "Zeroed-Out GRAT."

For the GRAT technique to prevail, it is only necessary is that the total return on the GRAT assets during the retained term exceeds the IRS interest rate for the month the GRAT is created – and assets will remain in the GRAT upon the term expiration to pass to heirs free of gift or estate tax implications. The GRAT is generally considered to be a "no lose" technique. If the growth on the assets in the GRAT exceeds the IRS interest rate, then assets will pass to the heirs at the term expiration and without tax liability. But if the GRAT assets do not grow at a rate that exceeds the IRS interest rate, then all the assets will be returned to the client in the form of the annuity payments. In the latter scenario the client winds up in the same position as if he had not implemented the GRAT.

The Zeroed-Out GRAT technique is enhanced when the annuity payment back to the client each year is "re-gifted" into a new Zeroed-Out GRAT, with this "rolling" structure of the annuity payments remaining in place for the balance of the client's lifetime. Given enough time and positive investment returns, very significant sums can be removed tax-free from one's estate.

Example:

Assume Dr. Baker, a 65 year-old retired physician, creates a $5 million Zeroed-Out GRAT for a 2 year term and the total investment return is 8% annually. Under the current applicable IRS interest rate of 2%, at the end of GRAT term more than $475,000 would remain in the GRAT to pass to his heirs free of gift or estate taxes. The annuity payments to Dr. Smith would be approximately $2.57 million annually, each of which could be promptly transferred upon receipt into new 2 year Zeroed-Out GRATs to obtain even greater estate tax savings.

The Irrevocable Life Insurance Trust. One tried and true technique estate tax savings technique is the Irrevocable Life Insurance Trust (or "ILIT"). The ILIT is a trust arrangement which utilizes gifting to take assets from one's estate and place the assets in an income and estate tax free environment—the ILIT.

Under this technique the client creates an ILIT and transfers money to the Trustee of the ILIT. With the money the Trustee then purchases a life insurance policy on the client's life. The terms of the ILIT generally parallel the client's Will or RLT and often provide that, upon the client's death, the insurance proceeds are paid out to the client's children.

A significant advantage of the ILIT is that the insurance proceeds are not subject to estate tax in the client's estate.This is not the case with life insurance which is personally owned. Another advantage is that the life insurance proceeds are not subject to income tax upon receipt by the heirs.

The ILIT technique, if contrasted, for example, with an IRA that is payable at death to one's children, demonstrates the ILIT's benefit. The IRA is subject to both estate and income tax – leaving perhaps as little as 30 cents on the dollar for the children after the client's death – while the insurance proceeds from the ILIT pass completely free of income and estate tax.

However, it is important to note that the transfers of money to the ILIT to pay the premiums are considered gifts, subject to the federal gift tax system, and thus must be structured in a manner to capture as many $13,000 Annual Exclusions (discussed below) as possible, so that the client's estate tax exemption is not unnecessarily consumed by cash gifts to the ILIT.

Also, an existing life insurance policy may be gifted to an ILIT and enjoy the same benefits discussed above. Unfortunately, in this situation the IRS imposes a 3 year "look back" rule. Specifically, if the client dies within 3 years of transferring the policy to the ILIT, the policy proceeds will be included in the client's estate for estate tax purposes. However, this 3 year look back rule can be avoided with proper estate planning techniques.

Qualified Personal Residence Trust. Another useful estate tax savings technique is known as the Qualified Personal Residence Trust (or "QPRT"). The QPRT is a trust arrangement authorized by IRS regulations which utilizes "leveraged" gifting. Under this technique the client transfers his primary home or vacation home to the QPRT and retains the right to reside at the home for a period of years set by the client, with ownership of the home generally passing to a trust for the spouse or children at the end of the set period.

Most gifts of property or money to a trust or to an individual are not "tax-efficient" – because the client's estate tax exemption will be reduced on a "dollar-for-dollar" basis by the value of the gift. However, under the QPRT technique, the reduction of the client's estate tax exemption is not the market value of the home (the "dollar-for-dollar" basis), as might be expected, but rather it is the market value of the home on the date of transfer to the QPRT minus the IRS stipulated value of the client's right to reside there for the set term of years. Thus, the QPRT only consumes a modest amount of the client's estate tax exemption (the value allocated to the children's future ownership component) but in reality passes a highly disproportionate value (the entire home) to the heirs when the QPRT term matures.

A downside to the QPRT is that the client must survive the term of the QPRT for the technique to work – or if not the home will be transferred back to the client's estate and included in the estate for estate tax purposes. However, this is not necessarily a bad result because the client's estate remains in the same position it would have been in had the QPRT not been created initially. Also, the IRS restores the exemption originally used by the QPRT. Thus, the client is no worse off than if he had not created the QPRT.

Example:
Mr. Jones, a 65 year-old retired executive, transfers his Florida home, worth $1 million, to a QPRT. Under the terms of the QPRT he retains the right to reside at the home for 15 years. Assuming the applicable IRS rate at that time is 2%, this transaction consumes less than $460,000 of Mr. Jones's estate tax exemption but, upon the expiration of the 15 year term (assuming a 4% appreciation rate), his home will be worth more than $1.8 million and will pass to his heirs free and clear of further gift or estate tax implications.
This above example is shows the power

of the "leveraged" gifting structure – using less than $460,000 in estate tax exemption to give away more than $1.8 million in real value to one's heirs.

Tax-free gifts — the annual exclusion and "med/ed" exclusion

Although making a gift under current gift tax law generally reduces one's exemption on a dollar-for-dollar basis, an important exception exists to this rule. Under section 2503(b) of the Internal Revenue Code, one can give away up to $13,000 per calendar year to as many individuals as desired without reducing one's exemption. This provision is often referred to as the "Annual Exclusion" and is indexed periodically for inflation. Furthermore, the gift is not taxable as income to the beneficiary.

For a senior client with numerous descendants, this special rule allows very significant value to be removed from the estate each year.

Example:
Mrs. Miller is an 80 year-old widow with an $8 million estate and she is concerned about paying estate taxes. Also, she has 4 children, each of whom is happily married, and 12 grandchildren. In total, she has 20 potential beneficiaries, including the children's spouses.

Utilizing the Annual Exclusion, Mrs. Miller could give away $260,000 every year to her 20 beneficiaries without any gift or estate tax consequences. And given a handful of years she could very easily reduce her estate to a point where it is less than the exemption and thereby completely eliminate her estate tax liability However, if Mrs. Miller instead decides to withhold these funds until her death, and then give the money to her family by bequest, each dollar held in excess of her exemption would first incur the estate tax before passing to the beneficiaries. Under present tax law, this correlates to a nearly $5,000 estate tax cost for every $13,000 amount Mrs. Miller decides to hold until death.

In addition to the Annual Exclusion, tax-free lifetime gifts may be paid directly to a health care provider or to an educational institution on behalf of another person pursuant to section 2503(e) of the Internal Revenue Code – often referred to as the "Med/Ed Exclusion." Importantly, there is no limit on the amount that may be paid and therefore these gifts do not reduce one's gift and estate exemption at all. However, it is important to note that such payments may be made to the educational institution only for tuition (room, board, books, etc. are excluded) or to the health care provider only for unreimbursed health care expenses. As well, there are other rules that apply in making such gifts, and legal counsel should be consulted prior to the initiation of any 2503(e) gifting plan.

Charitable giving and saving taxes

There are a variety of charitable giving techniques that can be of significant use, each with its benefits and drawbacks. However, perhaps the charitable options applicable to most clients are (i) the Charitable Remainder Trust (the "CRT"), (ii) the Charitable Lead Trust (the "CLT"), (iii) the Donor Advised Fund (the "DAF"), (iv) the Private Foundation (the "PF"), and (v) a direct gift to charity.

The Charitable Remainder Trust.
The CRT is a trust created either during lifetime or at death and which ultimately passes assets to charity. Typically the CRT lasts either for a term of years or for the beneficiary's lifetime and thereafter the assets of the CRT pass to the charity designated by the client. During the term of years or the beneficiary's lifetime, as the case may be, the CRT pays the beneficiary (usually the client) either a set amount each year or, alternatively, a percentage of the CRT asset value each year. Also, one can create a CRT for his or her own benefit, as well as for the benefit of another.

A primary reason for the popularity of the CRT is that it is a tax-exempt entity and thus it pays no income tax. Often a CRT is structured to be gifted a highly appreciated asset (such as stock) which, if sold by the client himself, would generate significant capital gains tax. However, if the CRT sells the stock, then no tax is then due because of the CRT's tax exempt status. Instead, as the beneficiary receives periodic payments from the CRT, the income earned by assets while held by CRT is allocated to the beneficiary's payments – who then reports the taxable income component on his or her tax return. Thus, the CRT has the effect of deferring capital gains taxation over many years while allowing the CRT to grow more significantly due to its tax-deferred status.

Further, upon the contribution of assets to the CRT during life, the client is entitled to an immediate income tax deduction commensurate with the portion of the CRT that is deemed to be charitable in nature.

The Charitable Lead Trust.
The CLT is essentially the inverse of the CRT and was made famous by being an integral part of Jacqueline Kennedy Onassis's Will.

Although there are a number of CLT

variations, under the typical CLT technique the client creates a trust – the CLT – at death, and the charity of the client's choice receives the initial or front-end "lead" payments. Upon the expiration of the lead interest, the balance of the CLT property typically passes to the client's children or other heirs.

The CLT technique is used not so much for its charitable component as it is to reduce the estate tax liability. The CLT tax savings is premised upon the expectation that the assets which pass to the CLT will be entitled to a significant estate tax charitable deduction, under IRS required tables, but, in actuality, the assets will be invested so as to significantly out-perform the promulgated IRS interest rate applicable to CLT gifts, thereby producing a larger, but deferred, inheritance for the heirs.

The Donor Advised Fund.
The DAF is a fund managed by a bank or investment company and which is classified by the IRS as a public tax-exempt charity. Generally the client establishes a small DAF account with the bank during life and, at death, a significant portion of the estate is bequeathed to the DAF. In creating the DAF account, the client customarily enters into a written agreement with the bank as to (i) which charities the client desires to benefit, and (ii) which family members are authorized to advise the bank as to potential charitable recipients in future years. The DAF then pays out the client's funds to charitable recipients as the years go along. Importantly, assets bequeathed to the DAF qualify in full for the estate tax charitable deduction. To save income taxes, it is common that the DAF is designated as the beneficiary of a high value IRA rather than as a beneficiary of the general estate.
Perhaps the main benefit of the DAF is that there is no administrative work required by the client or the client's family in the management of the DAF – and yet the designated family members have a valuable role in providing recommendations to the DAF relationship manager on a periodic basis as to which charities should receive funds from the DAF account for the year in question. Further, there is no cost to the client to create a DAF

The Private Foundation.
The PF is similar to the DAF in that it is a tax-exempt entity. However, it is different in that the client himself establishes the PF, either in the form of a trust or corporation, with the appropriate legal formalities, and then applies to the IRS for recognition of the PF as a tax-exempt entity. The client and the trustees or corporate officers of the PF, as the case may be, are responsible for the day-to-day administration of the PF, investment selection, tax compliance and reporting, and charitable beneficiary identification. Generally the PF is structured to be very focused as to its intended beneficiaries – such as scholarships to impoverished students attending a certain college. Upon the client's death it is common that additional estate assets are paid to the PF and maintained as a part of its charitable fund.

A main benefit to the PF is that the client can be very specific as to his or her intended beneficiaries and can hand-pick the trustees or corporate officers (often the client's children) who will carry out his or her intent. The main down-sides to the PF are (i) the personal responsibility borne by the client and his or her children to carry out the various administrative responsibilities of the PF, (ii) a much larger proportion of the PF's assets are consumed by administrative expenses as compared to a DAF, (iii) the initial set-up cost, and (iv) meeting the ongoing reporting and compliance requirements.

Direct Bequest to Charity.
One very "administratively" practical charitable giving option is to bequeath assets directly to charity when both the client and the client's spouse are deceased. For example, one could make an IRA payable at death to the Red Cross, and these funds would pass directly into the Red Cross's general budget. Also, it is common that clients with large value bequests enter into a written letter of understanding with the charity before the client's death as to how the client expects the bequest to be administered. This is typical with bequests payable to universities, prominent charitable organizations and major hospitals – which often have full time administrative officers to assist prospective donors in identifying the uses and purposes for the bequest. A further positive aspect to the direct bequest is that the client can revoke or alter the charitable bequest at any time.

Tax Benefits of Combining IRAs with Charitable Planning.
Perhaps the highest tax cost item to own, in terms of the total potential tax liabilities, is a tax-deferred retirement plan such as an IRA, 401(k) or 403(b) (hereinafter referred to generically as an "IRA"). It is not uncommon for the total post-death tax cost on an IRA to approach or exceed 70% of the IRA's value – by reason of the imposition of both the estate and income taxes. A similar consequence can occur with annuities if a significant portion of an annuity's value consists of tax-deferred income.

For the client who has (i) potential significant estate tax exposure, and (ii) a bona fide and significant charitable intent, an ideal option is to utilize the assets with the most "tax drag," such

as an IRA, to fund charitable gifts after both the husband and wife are deceased. Charitable gifts or bequests structured in an appropriate manner qualify in full for both the estate and income tax charitable deductions. These deductions have the effect of giving 100 cents of every IRA dollar to the charity or charities, rather than the alternative of leaving as little as 30 cents or less of every IRA dollar to one's heirs.

Example:
Dr. Williams is a 70 year-old retired engineering professor with no children. However, Dr. Williams wishes to leave enough money to his ten favorite nieces and nephews so that they will have a nest-egg and he has been a life-long supporter of his alma mater – the University of Florida. Dr. Williams' highest value asset is a $5 million IRA, and the value of his house and other assets equal $5 million – for a total estate of $10 million. Dr. Williams meets with his estate planning attorney, who determines that Dr. Williams has significant charitable intent and that $5 million (or $500,000 apiece) is in line with Dr. Williams' desires for his 10 nieces and nephews. If Dr. Williams left both his estate property and the IRA to his nieces and nephews, as little as $1.5 million of the IRA, in today's dollars, may wind up in their hands – with the rest going to the IRS in the form of estate and income taxes. However, upon his attorney's advice, an estate plan is executed by Dr. Williams which leaves his estate tax exemption (currently $5 million) to his nieces and nephews and designates the University of Florida School of Engineering as the beneficiary of his IRA at death. In this case, Dr. Williams' new estate plan positions him to use his estate to provide his nieces and nephews a $5 million inheritance while simultaneously benefiting his alma mater with a $5 million engineering scholarship fund – and pay no estate or income taxes.

Minimize inter-generational taxes with GST tax planning

The GST tax is a tax imposed on any gift or bequest to a person who is 2 or more generations younger (referred to as a "Skip Person" by the IRS) than the person making the gift or bequest. The GST tax exemption for 2011 and 2012 is $5 million and, as with the estate tax, will revert to $1 million (indexed for inflation) in 2013 unless Congress takes remedial action. Lifetime gifts or bequests to a Skip Person which exceed the exemption incur a GST tax (currently 35%) in addition to any gift or estate tax. Therefore, it is usually recommended that clients not give or bequeath an amount in excess of their GST exemption to their grandchildren due to the draconian result of the GST tax. Nevertheless, important planning opportunities are available to minimize the total death tax cost that a family would otherwise incur over multiple generations.

The primary opportunity in the GST tax planning arena is to create an estate plan that benefits one's children with an inheritance for life and then passes to the grandchildren – but the inheritance bears no estate or GST tax at the child's death. Such a plan is typically referred to as a "generation skipping" plan or a "lifetime trust" plan.

At the death of a single person, or the death of the survivor of a married couple, the estate will pay any estate tax owed and then typically pass as an outright inheritance to the adult children. Although such an inheritance format is very straight-forward, it often comes at a huge tax cost – the estate tax will be paid a second time on the inheritance at each child's later death because the inheritance is then a part of the child's own estate.

This double tax concern can be mitigated or eliminated by the use of the "generation skipping" or "lifetime trust" plan. Under this plan, a child's inheritance is not given to him or her outright but is instead placed in trust for the child for life. Although the child will receive the economic benefit of the trust, no estate or GST taxes will be owed at the child's death to the extent that the parents' GST exemption is allocated to the child's trust.

Example:
Mr. and Mrs. Taylor are in their 70's and have a combined estate of $10 million. They also have 2 adult children in their 40's. Both children are successful professionals with estate tax concerns of their own. The Taylors know that with proper planning they can protect their entire estate from the estate tax when they are both gone by use of their separate $5 million exemptions. However, the Taylors are concerned that their estate, once in the hands of their children, will bear significant estate tax at the death of each child. The Taylors meet with their estate planning attorney, who advises them that their tax concerns can be eliminated by the use of a "generation skipping" or "lifetime trust" plan.

The attorney advises the Taylors that, under this plan, after they are deceased each of their children will receive a one-half share of their estate, or $5 million each, in trust for life – and that the Taylors combined $10 million GST tax exemption will be allocated to those trusts. The terms of the trusts will provide that each child will be the sole Trustee of his or her trust and the primary beneficiary of the trust. The attorney further advises

the Taylors that each child may even be allowed to determine who will inherit their trusts at death – just as they would have been able to with an outright inheritance. And, even more, upon each child's death the child's trust, regardless of the amount it has appreciated to, will pass to the child's heirs free of estate or GST taxes. Their attorney advises them that IRS simply deems the trusts not to be a part of the children's personal estates for estate tax purposes.

Also, in lieu of a child serving as the sole Trustee of his or her Generation Skipping Trust, it is often advantageous to have a corporate fiduciary, such as KeyBank, serve a co-Trustee with the child, or, alternatively, as the sole Trustee. As noted above, a corporate fiduciary provides a number of important services that may not be achieved by an individual Trustee. For example, the corporate fiduciary ensures that all ongoing legal and tax matters of the Generation Skipping Trust are handled properly, such as the preparation and filing of the Generation Skipping Trust's federal income tax returns and annual beneficiary accounting. The corporate fiduciary also serves to ensure that the Generation Skipping Trust assets are invested in accordance with accepted professional standards and that the distribution and investment provisions set forth in the Trust are followed. Also, a corporate fiduciary is the appropriate choice in a number of particular situations, such as for the child who (i) has or may develop substance abuse problems, (ii) is mentally impaired, (iii) may potentially fall under the influence of outside parties, or (iv) does not handle resources and investing in a prudent manner. Utilizing a corporate fiduciary as the sole or co-Trustee of the Generation-Skipping Trust eliminates such problematic issues by ensuring that the Trust assets are properly managed and that the child's inheritance is protected from improper depletion and the influence of outside parties.

In addition to the "generation skipping" or "lifetime trust" plan, there are a number of other viable techniques to mitigate a family's total death tax cost over multiple generations.

Article VII.

Foreign citizens with Florida connections

Foreign citizens who seasonally or permanently reside in Florida, or own Florida real estate, are often under the impression that they are exempt from the federal estate and gift tax regime. However, this is generally not the case – and a failure to adequately plan for the transfer tax can produce unexpected and expensive results. In fact, a recent article in Trusts and Estates magazine focused on non-U.S. citizens and reported that they routinely fail to sufficiently plan for the U.S. gift and estate tax system and noted the "extraordinarily high costs of not planning."

One question every foreign citizen must consider is whether he or she is a "resident" of the U.S. for gift and estate tax purposes. Under federal gift and estate tax law, a person is a U.S. tax resident if he has his "domicile" in the U.S. – even if he doesn't hold a "green card." Under IRS rules a person obtains a U.S. "domicile" by living here for any period, however brief, with no definite intention to move elsewhere. Surprisingly, the IRS holds that even non-immigrant visa holders may be treated as U.S. tax residents. Consequently, the determination of domicile is often a matter of dispute between the IRS and wealthy foreign citizens and their estates.

Importantly, if a person is a resident for U.S. gift and estate tax purposes, then his or her world-wide estate is subject to this tax system. However, for non-residents the gift and estate tax only is applicable to their "U.S. property." Also, important "loop-holes" in non-resident tax law offer forward-looking non-residents significant planning opportunities to minimize or eliminate tax liability.

Specifically, the federal gift tax applies to gifts a non-resident makes of U.S. property (subject to any applicable exclusions or deductions). For gift tax purposes, "U.S. property" generally includes tangible personal property (including cash) and real estate located in the United States. Intangible assets, including stock in a U.S. company, are not considered "U.S. property" for gift tax purposes. However, for estate tax purposes, a non-resident's "U.S. property" is more broadly defined and does include stock in a U.S. company and many other assets as well. Surprisingly, a non-resident is not entitled to any gift tax exemption and only a $60,000 estate tax exemption. The lack of significant non-resident tax exemptions can produce disastrous tax results to a wealthy non-resident who owns or transfers "U.S. property." Therefore, planning for a non-resident often involves converting U.S. property to foreign property before death or becoming a U.S. resident to obtain the larger estate tax exemption ($5 million through 2012).

Also, an estate is entitled to an unlimited estate tax deduction for property passing to a surviving spouse if that spouse is a U.S. citizen. This critical deduction protects the "marital estate" from estate tax liability until both spouses are deceased. However, this deduction is not available in the case of a surviving spouse who is a foreign citizen unless very restrictive trust

provisions are implemented to hold the survivor's inheritance. Consequently, if one or both spouses are foreign citizens, it is of great importance to take steps to protect the first to die spouse's estate from the estate tax.

Further, foreign citizens should be aware that tax treaties exist which may alter the general rules discussed above. Finally, U.S. estate planning for the wealthy foreign citizen can be a complicated and extensive process. And, although a complete analysis of estate planning for the foreign citizen is beyond the scope of this material, it is nevertheless critical to point out that the foreign citizen must be highly pro-active and take sufficient legal steps, both with U.S. and foreign legal counsel, to ensure that an appropriate estate and tax plan is implemented.

Article VIII.

Florida's popularity as a retirement destination will likely continue well into the 21st century and beyond. And regardless of whether you are a newcomer to Florida or a longtime resident of the sunshine state, it is critically important that you have a Florida estate plan in order – both to properly establish a Florida tax residency and, even more, to ensure that your wishes at death and concerns for your heirs are properly addressed. KeyBank has a long-standing history of providing full service investment management services to its clients as well as serving as a professional Personal Representative and Trustee for their Estates and Trusts. If the officers at KeyBank or the author of this guide may be of assistance to you, please do not hesitate to contact us. It would be our pleasure to help you.

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