HOW BENEFICIAL IS FLORIDA'S COMMUNITY PROPERTY TRUST ACT TO THE MARITAL ESTATE? A LEGISLATIVE ANALYSIS OF FLORIDA'S COMMUNITY PROPERTY TRUST ACT

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I. INTRODUCTION

Florida is a migratory state, famous for its tropical climate and its generous tax laws.[1] Now, Florida is joining Alaska, Tennessee, South Dakota, and Kentucky in offering a Community Property Trust for marital property.[2] One of the benefits of a Community Property Trust Act ("CPTA") is that when a spouse owning community property dies, the basis of both the deceased spouse's and the surviving spouse's (50%) shares of the property are adjusted to the

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[1] *See* Grace Dean, *Tech Jobs, Sun, and No Income Tax: Experts Explain Why Florida is Posed to Keep Growing Even After the Pandemic,* INSIDER (May 21, 2021, 10:57 AM), https://www.businessinsider.com/florida-growth-jobs-economy-population-new-york-pandemic-employment-miami-2021-4 (explaining that Florida is notable for not having personal income tax unlike other big cities); *see also Considering a Move to Florida? What You Need to Know about Changing Domicile*, PNC INSIGHTS (Aug. 12, 2021), https://www.pnc.com/insights/wealth-management/markets-economy/considering-a-move-to-florida-what-you-need-to-know.html ("Florida is becoming a preferred destination for more than 330,000 individuals annually.").

[2] *See Florida Creates "Community Property" Opportunity,* SANIBEL CAPTIVA TR. CO. (Sept. 27, 2021), https://www.sancaptrustco.com/florida-creates-community-property-opportunity/ ("Florida has now joined Alaska, Tennessee, South Dakota and Kentucky to become the fifth state to provide its citizens with the opportunity to create Community Property Trusts."); *see also* Tanza Loudenback, *In 9 US States, A Divorce Could Mean Losing Half of Everything You Own,* INSIDER (Jan. 21, 2020, 10:05 AM), https://www.businessinsider.com/personal-finance/which-states-are-community-property-states-in-divorce ("The states that observe this law are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Residents of Alaska can opt-in to a community property agreement.").

property's fair market value at the date of the decedent spouse's death.[3] This sort of tax adjustment is referred to as a "double step-up in basis," and as long as the community property has appreciated, it results in a tax benefit for the beneficiary of the property.[4]

An analysis of Florida's CPTA reveals that it is misleading in several ways. First, it gives estate planners the option to make the trust irrevocable; however, if a married couple were to place their homestead property in an irrevocable trust, they would lose their homestead exemption which affects the way the property is taxed.[5] Second, if one spouse dies and the surviving spouse is a non-citizen of the United States, and the decedent left their property to the surviving non-citizen spouse, that spouse is now subject to gift taxation rates as applicable to non-citizens under the Internal Revenue Services ("IRS") code.[6] Lastly, this new legislation does not clearly state whether the assets used to fund the trust would be classified for tax-exempt purposes.[7]

This Comment will analyze the Florida Community Property Trust Act by closely evaluating the statute itself.[8] Part II will offer background information on the CPTA, including definitions of essential terms.[9] Part III, section A, will analyze the risk of providing an irrevocable trust as an option for homestead

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[3] *See* Osvaldo Garcia & Jennifer Wioncek, *Florida's Proposed Directed Trust and Community Property Trust Statutes: What You Need to Know*, BILZIN SUMBERG – JD SUPRA (Apr. 21, 2021), https://www.jdsupra.com/legalnews/florida-s-proposed-directed-trust-and-1350125/ (explaining that this is authorized pursuant to the Internal Revenue Code); *see also* Matthew Tuller, *How a Community Property Trust Could Save You From Heavy Taxation*, L. OFF. OF MATTHEW J. TULLER (Sept. 23, 2019), https://www.tullerlaw.com/blog1/2019/1/4/how-a-community-property-trust-could-save-you-from-heavy-taxation ("Because of a tax loophole, community property receives a basis adjustment step-up on the entire property when one of the spouses dies.").

[4] *See* Garcia & Wioncek, *supra* note 3 (explaining that this tax treatment is superior to ownership of real property as joint tenants because only one spouse's half interest receives a step-up in basis "resulting in a large tax burden upon disposition of the asset."); s*ee also* Will Kenton, *Step-up in Basis*, INVESTOPEDIA, (Aug. 20, 2021), https://www.investopedia.com/terms/s/stepupinbasis.asp (explaining that step-up in basis taxation has often been used by the rich as loophole to minimize their tax burden).

[5] *See* FLA. CONST. art. X, § 4 (stating that a natural person must own the homestead property); *see also* Karen Rogers, *Homestead Exemption in Regard to Living Trusts*, ZACKS, https://finance.zacks.com/homestead-exemption-regard-living-trusts-11539.html (last visited May 9, 2022) (explaining that the homestead exemption remains with the owner and the exemption may be lost when placed in a trust).

[6] *See* Garcia & Wioncek, *supra* note 3 ("If one such spouse is not a United States citizen, then the contribution of separate property by the other spouse would not qualify for the unlimited marital deduction benefit and could trigger a U.S. federal gift tax situation."); *see also* 26 U.S.C. § 2056(d) (2020) (stating that if the surviving spouse is not a United States citizen, a martial deduction is impermissible).

[7] *See* Garcia & Wioncek, *supra* note 3 ("However, there has been debate within the tax field (without an ultimate consensus), as to whether community property trusts settled in a non-community property state such as Florida are, in fact, entitled to the double basis adjustment."); *see also* Comm'r of Internal Revenue Serv. v. Harmon, 323 U.S. 44, 48 (1944) (holding that an Oklahoma statute allowing couples to opt-in to a community property regime could not be recognized for federal income tax purposes).

[8] *See infra* Parts I–IV.

[9] *See infra* Part II.

property and offer a novel solution that proposes an amendment to the CPTA to eliminate irrevocable trusts.[10] Part III, section B, will analyze the issue of devising property to a non-citizen spouse for tax purposes and propose a tax exemption for non-citizen spouses with a community property trust.[11] Part III, section C, will analyze the uncertainty regarding how the IRS will treat community property trusts settled in a non-community state and will recommend clarity in the law as it refers to this issue.[12] Part IV will state the novel solutions proposed for each critique.[13] Lastly, part V will summarize the analysis done throughout the comment and conclude.[14]

II. BACKGROUND

On July 1, 2021, Florida adopted Florida's Community Property Trust Act ("CPTA").[15] The CPTA allows married couples to form a community property trust and fund it with the marital property treated as community property.[16] This new legislation "gives the settlor spouses broad discretion to structure the trust as they wish, including determining whether the trust shall be revocable or irrevocable and how the trust property shall be disposed upon death or divorce."[17] Another advantage of the CPTA is that the settlor spouses do not have to live in Florida; only the Trustee must.[18] However, the ultimate benefit of the CPTA is having all the property in the trust receive a step-up based on the fair market value at the time of death of the first spouse and second spouse.[19]

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[10] *See infra* Part III.
[11] *See infra* Part III.
[12] *See infra* Part III.
[13] *See infra* Part IV.
[14] *See infra* Part V.
[15] *See* FLA. STAT. § 736.1502(2) (2021) ("'Community property trust' means an express trust that complies with s. 736.1503 and is created on or after July 1, 2021."); *see also* Karen Kayes, *The New Rules of Florida Trusts Are Here*, WARNER NORCROSS + JUDD (Aug. 30, 2021), https://www.wnj.com/Blogs/Private-Client-and-Family-Office-Blog/August-2021/The-New-Rules-for-Florida-Trusts-Are-Here (noting that the Florida Community Property Trust Act became effective on July 1, 2021).
[16] *See* Kayes, *supra* note 15 ("[T]he CPTA essentially allows couples to opt into a community property situation by creating a community property trust (CPT) and treating property that is transferred to the trust as community property."); *see also* FLA. STAT. § 736.1502(1) (defining community property as "the property and the appreciation of and income from the property owned by a qualified trustee of a community property trust during the marriage of the settlor spouses. The property owned by a community property . . . shall be deemed to be community property[.]").
[17] Garcia & Wioncek, *supra* note 3 (noting that a surviving spouse may amend the trust with respect to their half without regard for whether the trust is irrevocable or revocable); *see also* FLA. STAT. § 736.1504(1)(d) (2021) (explaining how the settlor spouses may use the CPTA, specifically that it can be formed as either a revocable or irrevocable trust).
[18] *See* Kayes, *supra* note 15 (clarifying that the spouses do not have to be domiciled in Florida in order to create a CPTA within the state); *see also* FLA. STAT. § 736.1505(1) (2021) ("Whether both, one, or neither is domiciled in the state, settlor spouses may classify any or all of their property as community property by transferring that property to a community property trust[.]").
[19] *See* Alan Gassman, *Florida Community Property Trust*, ATL. WEALTH PARTNERS (June 18, 2021), https://www.atlanticwp.com/florida-community-property-trusts/ (explaining that for most married couples, the sole benefit of having a community property trust is for purposes of the double

Community property is governed by statutory and judicial laws that have developed in community property states.[20] The IRS is one of the central governing bodies with respect to community property, and it describes community property as "(1) property that one or both spouses acquire during their marriage (or domestic partnership) while residing in a community property state, (2) property the spouses agreed to convert from separate property to community property, or (3) property that simply cannot be deemed separate."[21] It is important to note that upon the death of the first spouse, the deceased spouse's interest in the community property does not pass automatically to the surviving spouse; instead, the testator must explicitly devise it to the surviving spouse if that is their wish.[22] Notably, one of the most significant advantages of owning community property is its double step-up in basis taxation, which essentially re-evaluates each spouse's share of the property at the time of their death.[23]

A. BACKGROUND ON DOUBLE STEP-UP IN BASIS

When an asset receives a step-up in basis, the asset's value has been readjusted to the fair market value when it passes from its owner to its heir.[24] Typically, the asset's value will be higher at the time of inheritance than at the time of purchase, so the step-up in basis allows the beneficiary to minimize capital gains tax.[25] Now, a double step-up in basis simply means that the asset will

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step-up in basis); *see also* Tuller, *supra* note 3 (commenting that "[o]ne of the best parts of estate planning is that you get out so much more than you put in.").

[20] *See* Richard B. Toolson, Phd, CPA, *Our Greatest Hits | Community Property Step-Up in Basis*, CPA J. (Aug. 2017), https://www.cpajournal.com/2017/08/18/greatest-hits-community-property-step-basis/ (explaining that not having one governing body of law means that tax planners need to examine the statutes and case law of the individual state); *see also* Terrance J. Mullin, *Understanding the Testamentary Effects of Community Property Rules*, 79 FLA. B.J. 49 (Jan. 2005) (explaining that states maintain their own varying sets of rules).

[21] ERICA K. SMITH, BASIC ESTATE PLANNING IN FLORIDA § 14.2.A (10th ed. 2020) (providing background information on what the IRS considers to be Community Property). *But see* Toolson, *supra* note 20 ("Consequently, there is not a consistent, uniform set of community-property laws. Ultimately, the tax planner needs to examine the statutes and case law of the particular individual community-property state to determine whether property should be classified as community property.").

[22] *See* SMITH, *supra* note 21, § 14.2.B.1 (explaining that each spouse owns their undivided interest in half of the property, therefore they are free to devise that half as they wish); *see also* Garcia & Wioncek, *supra* note 3 (explaining that the IRS also treats the property as each spouse owning an undivided one half interest in the property).

[23] *See* Garcia & Wioncek, *supra* note 3 ("From a U.S. tax planning perspective, there is one significant benefit for married couples subject to a community property regime."); *see also* Holt v. United States, 39 Fed. Cl. 525, 526–27 (1997) ("Subsection 1014(a) of the Tax Code sets out as a general rule that the basis of property acquired or passed from a decedent is its fair market value at the time of the decedent's death[.]").

[24] *See* Kenton, *supra* note 4 ("Put simply, a step-up in basis adjusts the value of an asset when it passes from an owner to their heir. The higher market value of the asset at the time of inheritance is considered for tax purposes."); *see also* 26 U.S.C. § 1014(a)(1) (2020) (stating that the basis of property being devised should be the fair market value on the date of death); *id.* at § 61(a)(3) (defining gross income as, but not limited to, gains derived from real property).

[25] *See Step-Up In Basis*, TAX FOUND., https://taxfoundation.org/tax-basics/step-up-in-basis/ (last visited May 9, 2022) (explaining that the step-up in basis "eliminates the capital gain that occurred

receive a step-up in basis twice: once when the first spouse passes, and again when the surviving spouse dies.[26]

For instance, a married couple – Allan and Jo Ann – purchased a home in 1977 for $350,000.[27] Allan passed away first in 2006, and at the time, the house received a step-up in basis for its market value of $500,000.[28] Jo Ann passed away in 2015, leaving the property valued at $700,000 to their daughter Stephanie.[29] As a result of the double step-up in basis, "Stephanie inherits a home that steps up in basis twice and avoids paying a large amount of taxes because of the double step-up rule."[30] Significantly, this only affects Stephanie once she decides to sell the home.[31]

B. BACKGROUND ON IRREVOCABLE TRUSTS

An irrevocable trust is a type of trust that, once funded, the grantor is no longer allowed to modify.[32] More importantly, once the grantor transfers their

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between the original purchase of the asset and the heir's acquisition, reducing the heir's tax liability."); *see also Holt*, 39 Fed. Cl. at 526–27 (discussing what each subsection under section 1014 of the Tax Code is intended to do).

[26] *See* Jim Freeman, CFP, *Step-Up in Cost Basis: What California Residents Need to Know*, FIN. ALTS. (Dec. 20, 2020), https://www.financialalternatives.com/financial-alternatives-inc/2020/12/20/step-up-in-cost-basis-what-california-residents-need-to-know ("[A]n inherited asset gets stepped up twice in a community property state: once for the surviving spouse and a second time for the ultimate beneficiary."); *see also* Garcia & Wioncek, *supra* note 3 (explaining that pursuant to the Internal Revenue Code each time a spouse passes the asset receives a step-up in basis).

[27] *See* Kenton, *supra* note 4 ("They had a revocable living trust established and deeded the house to the trust."); *see also* Julia Kagan, *Irrevocable Trust*, INVESTOPEDIA (Dec. 9, 2021), https://www.investopedia.com/terms/i/irrevocabletrust.asp (defining a revocable trust as a trust that may be "amended or canceled at any time as long as their creator is mentally competent.").

[28] *See* Kenton, *supra* note 4 (noting that the house stayed in the revocable living trust after the husband's death); *see also* James F. Roberts, *The Double Step-Up: Why It's Important When Creating an Estate Plan*, L. OFF. OF JAMES F. ROBERTS & ASSOCS., APC, https://www.webuildyourtrust.com/the-double-step-up-why-it-s-important-when-creating-an-estate-plan/ (last visited May 9, 2022) (defining a step-up in basis by stating that an "asset becomes its value at your date of death, rather than the basis that you had while living.").

[29] *See* Kenton, *supra* note 4 (noting that the home's market value of $700,000 is Stephanie's cost basis); *see also* Roberts, *supra* note 28 ("For the children or other beneficiaries of this couple, this can create a substantial tax savings.").

[30] Kenton, *supra* note 4 (explaining that if Stephanie decides to sell the home, she will pay taxes on the difference between the selling price and the double step-up in basis); *see also* Roberts, *supra* note 28 ("This generally allows for a significant tax savings for your loved ones, who can potentially avoid or minimize the capital gains tax that will be due when they sell the asset after your death.").

[31] *See* Kenton, *supra* note 4 ("[I]f there wasn't a step-up in basis, then the beneficiary would have to pay taxes on the difference between the selling price of [$700,000] and the initial buying price of $300,000[.]"); *see also* Matthew Tuller, *Integrating Community Property Trust Into Your Estate Plan*, L. OFF. OF MATTHEW J. TULLER (Sept. 30, 2019), https://www.tuller-law.com/blog1/2019/1/4/integrating-community-property-trust-into-your-estate-plan (explaining that the step-up in basis minimizes capital gains tax when either a surviving spouse or the decedent's heir wants to sell the property).

[32] *See* Kagan, *supra* note 27 ("The term irrevocable trust refers to a type of trust where its terms cannot be modified, amended, or terminated without the permission of the grantor's beneficiary or beneficiaries."); *see also* Julie Garber, *What Is Funding a Trust?*, THE BALANCE, https://www.thebalance.com/what-does-it-mean-to-fund-a-trust-3505280 (Mar. 2, 2022) ("Funding a trust is the

funds into the trust, they have effectively relinquished all of their ownership rights over those assets.[33] Once the trust is funded, "[t]he trust now legally owns the assets, which have been retitled or registered in the trust's name, and since the trust property is no longer yours, it will have no bearing on the value of your estate or your tax liability."[34] An irrevocable trust is often created for the protection and division of an estate—for instance: "[t]o take advantage of the estate tax exemption and remove taxable assets from the estate [;]" "[t]o prevent beneficiaries from misusing assets;" and "[t]o gift assets to the estate while still retaining the income from the assets."[35]

C. BACKGROUND ON REVOCABLE TRUSTS

Contrary to an irrevocable trust, a revocable trust is one that "can be amended or revoked as the grantor desires and is included in estate taxes."[36] It is common practice for the grantor of a trust to also act as the trustee of the revocable trust because the trust agreement will provide for a successor trustee. Upon the grantor's death, the trust becomes irrevocable.[37] For tax and legal purposes, an important consideration is, "[w]hen you transfer assets into a revocable trust, you still legally retain ownership over the property . . . so you [will not] get the same sheltering tax benefits of an irrevocable trust."[38]

D. BACKGROUND ON UNLIMITED MARITAL DEDUCTION

The unlimited marital deduction is an estate tax provision that allows spouses to transfer an unlimited amount of money amongst each other, including by devise at any point during the marriage, without incurring any penalties

process of transferring your assets to the ownership of your trust.").

[33] *See* Kagan, *supra* note 27 (explaining that by transferring funds into an irrevocable trust, the grantor legally removes all of their ownership rights over the assets); *see also* Elissa Suh, *What Is An Rrrevocable Trust and How Does It Work?*, POLICYGENIUS, https://www.policygenius.com/trusts/what-is-an-irrevocable-trust-and-how-does-it-work/ (Sept. 7, 2021) ("When you transfer your assets into an irrevocable trust, you *relinquish*, or give up, control of them.").

[34] Suh, *supra* note 33 (explaining that now the trust becomes the legal owner of the assets); *see also* Kagan, *supra* note 27 ("[A]n irrevocable trust removes certain assets from a grantor's taxable estate, and these incidents of ownership are transferred to a trust.").

[35] Kagan, *supra* note 27 (listing several benefits that come with creating an irrevocable trust); *see also* Suh, *supra* note 33 ("[I]rrevocable trusts come equipped with many advantages, like tax benefits and asset protection, that can make getting one worthwhile [for] some people.").

[36] Julia Kagan, *Revocable Trust*, INVESTOPEDIA, https://www.investopedia.com/terms/r/revocabletrust.asp (Mar. 9, 2022) (explaining that an revocable trust may be amended as the grantor desires); *see also* Suh, *supra* note 33 (noting that a revocable trust is the opposite of an irrevocable trust because it allows for changes to be made to it up until the point of the grantor's death).

[37] *See* Kagan, *supra* note 36 (noting that once the grantor dies, the trust converts from revocable to irrevocable); *see also* Suh, *supra* note 33 ("Revocable trusts become irrevocable after the grantor passes away.").

[38] Suh, *supra* note 33 (emphasizing the distinction between revocable and irrevocable trusts in regard to taxation); *see also* Kagan, *supra* note 36 ("A revocable trust does not offer the grantor tax advantages.").

or additional taxation.[39] In essence, this provision treats the married couple as "one economic unit."[40] Additionally, "the unlimited marital deduction allows married couples to delay the payment of estate taxes upon the death of the first spouse because after the surviving spouse dies, all assets in the estate over the applicable exclusion amount are included in the survivor's taxable estate."[41] Additionally, "the unlimited marital deduction allows married couples to delay the payment of estate taxes upon the first spouse's death[]" because "[a]fter the surviving spouse dies, all assets in the estate over the applicable exclusion amount will be included in the survivor's taxable estate."[42] Importantly, the unlimited marital deduction is not allowed for the transfer of property to a non-citizen spouse.[43]

E. BACKGROUND ON HOMESTEAD EXEMPTION

The Florida homestead exemption is a provision governed by the state's constitution that shields the home from a forced sale and most creditors.[44] This exemption provides ongoing protection to surviving spouses.[45] Significantly, only a natural person may claim the exemption.[46] In essence, the homestead

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[39] *See* Julia Kagan, *Unlimited Marital Deduction*, INVESTOPEDIA, https://www.investopedia.com/terms/u/unlimited-marital-deduction.asp (Dec. 26, 2021) ("The unlimited marital deduction is considered an estate preservation tool because assets can be distributed to surviving spouses without incurring estate or gift tax liabilities."); *see also* 26 U.S.C. § 2523(a) (2020) (granting a tax deduction for property interests that are transferred as gifts between spouses).

[40] *See* Kagan, *supra* note 40 (explaining that because the provision eliminates both the federal estate and gift tax on transfers of property, it is considering the married couple as one person under the law); *see also* Ashley Kilroy, *How Does an Estate Tax Marital Deduction Work?*, SMARTASSET (Mar. 30, 2021), https://smartasset.com/estate-planning/estate-tax-marital-deduction ("The surviving spouse then inherits this property without paying an estate tax on it.").

[41] *See* Kagan, *supra* note 36 (explaining that the unlimited marital deduction allows married couples to delay the payment of estate taxes when the first spouse dies; but once the suriving spouse also dies, all the assets in the estate will be taxed accordingly); *see also* Kilroy, *supra* note 41 ("[W]hile you do not have to pay them after the first spouse's death or transfer, the taxes will apply when the surviving spouse passes.").

[42] Kagan, *supra* note 40; *see* Kilroy, *supra* note 41 ("[W]hile you do not have to pay [estate and gift taxes] after the first spouse's death or transfer, the taxes will apply when the surviving spouse passes.").

[43] *See* Julie Garber, *The Unlimited Marital Deduction and Your Taxes*, THE BALANCE, https://www.thebalance.com/unlimited-marital-deduction-3505622 (Feb. 3, 2022) ("The deduction is not allowed if the spouse of the person making the gift is not a U.S. citizen."); *see also* 26 U.S.C. § 2056(d)(1)(A) (2020) (noting that if the surviving spouse of the decedent is not a U.S. citizen, no deduction is allowed).

[44] *See* FLA. CONST. art. X, § 4(a) (noting that a homestead property is exempt "from forced sale under process of any court, and no judgment, decree or execution shall be a lien thereon."); *see also* Julia Kagan, *Homestead Exemption*, INVESTOPEDIA, https://www.investopedia.com/terms/h/homestead-exemption.asp (Aug. 25, 2021) (explaining that the homestead exemption shields a home from some creditors and bankruptcy).

[45] *See* Kagan, *supra* note 44 ("The homestead tax exemption can also provide surviving spouses with ongoing property tax relief . . . ."); *see also* FLA. CONST. art. X, § 4(2)(b) ("These exemptions shall inure to the surviving spouse or heirs of the owner.").

[46] *See* FLA. CONST. art. X, § 4(a) (requiring that the homestead property must be owned by a natural person); *see also Florida Homestead Exemption and Requirements,* DEEDCLAIM,

exemption guarantees a maximum exemption from property taxes, and it "also protects the value of residents' homes from property taxes, creditors, and circumstances that arise from the death of the homeowner's spouse."[47]

III. DISCUSSION

A. THE DOWNFALLS OF UTILIZING AN IRREVOCABLE TRUST FOR HOMESTEAD PROPERTY

The CPTA offers grantors the option of forming either a revocable or irrevocable trust.[48] The downfall of this is that if the grantors place their homestead property in an irrevocable trust, the grantors are relinquishing their homestead exemption.[49] Crucially, "[b]ecause the homestead exemption remains with the owner, you may lose the homestead exemption once the trust takes title to the property."[50] Along with the homestead exemption, the grantors relinquish all legal and equitable title to the assets.[51]

Both an irrevocable trust and the homestead exemption offer protection from creditors, assurances that the property devises within the bloodline or to a designated beneficiary, and ongoing tax protection.[52] Accordingly, to the grantors, it may appear like they have nothing to lose; however, by placing their homestead property in an irrevocable trust, they vest legal ownership of the assets in the trustee.[53]

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https://www.deedclaim.com/florida/homestead/ (last visited May 9, 2022) ("If the property is owned by a corporation or a limited liability company, for example, it will not qualify for Florida homestead protection.").

[47] Kagan, *supra* note 44; *see Florida Homestead Exemption and Requirements*, *supra* note 46 (explaining that the homestead provision is meant to shield the surviving spouse and surviving minor children).

[48] *See* FLA. STAT. § 736.1504(d) (clarifying that the trust may be either revocable or irrevocable); *see also* Garcia & Wioncek, *supra* note 3 ("The CPTA further gives the settlor spouses broad discretion to structure the trust as they wish, including determining whether the trust shall be revocable or irrevocable . . . .").

[49] *See* Zina Kumok, *Life Estate vs. Irrevocable Trust: What's the Difference?*, INVESTOPEDIA, https://www.investopedia.com/articles/investing/010716/life-estate-vs-irrevocable-trust-which-better-you.asp (Aug. 8, 2021) ("One of the downsides of an irrevocable trust is that the founder of the trust relinquishes any rights they have to the home."); *see also* Rogers, *supra* note 5 ("The homestead property remains in the trust indefinitely.").

[50] Rogers, *supra* note 5; *see* FLA. CONST. art. X, § 4(a) (highlighting that the homestead property must be owned by a natural person to inure the benefits of homestead exemption).

[51] *See* Kagan, *supra* note 27 ("The grantor, having effectively transferred all ownership of assets into the trust, legally removes all of their rights of ownership to the assets and the trust."); *see also* Rogers, *supra* note 5 (explaining that once property is transferred into an irrevocable trust, the right to own and control the property is transferred as well).

[52] *See* Daniel A. Timins, *The (Only) 3 Reasons You Should Have an Irrevocable Trust*, KIPLINGER (July 27, 2020), https://www.kiplinger.com/retirement/estate-planning/601127/the-only-3-reasons-you-should-have-an-irrevocable-trust (listing the benefits of an irrevocable trust, such as the ability to minimize tax estates and asset protection from creditors); *see also* Kagan, *supra* note 44 (explaining that homestead exemption shields a home from creditors and provides ongoing property tax relief).

[53] *See* Kagan, *supra* note 27 ("Under an irrevocable trust, legal ownership of the trust is held by a

Pursuant to Fla. Stat. § 736.151(1), "[p]roperty that is transferred to or acquired subject to a community property trust may continue to qualify or may initially qualify as the settlor spouses' homestead . . . ."[54] Further, "[t]he settlor spouses shall be deemed to have beneficial title in equity to the homestead property held subject to a community property trust for all purposes . . . ."[55] The purpose of this provision is to allow settlors of a community property trust to retain their homestead exemption.[56] However, it is unclear if the provision also applies to an irrevocable community property trust because a settlor loses the legal and equitable title.[57] A settlor of an irrevocable trust loses both legal and equitable title because legal title vests in the trustee and equitable title vests in the beneficiaries.[58] Thus, this provision contradicts the nature of an irrevocable trust.[59]

Case law supports the application of the homestead provision as it pertains to a revocable trust.[60] For instance, in *Engelke v. Estate of Engelke*, the trustee of the decedent's revocable trust appealed an order from the probate court requiring the trust to pay from the homestead property expenses not covered by estate assets.[61] In this case, the court held that the homestead property held in a

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trustee."); *see also* Timins, *supra* note 52 (explaining that property transferred into an irrevocable trust is no longer in the grantor's control).

[54] FLA. STAT. § 736.151(1). *But see* Kagan*, supra* note 27 (explaining that trust settlors transfer all ownership interest to the trust).

[55] FLA. STAT. § 736.151(2). *But see Trust, Irrevocable,* REALIZED, https://www.realized1031.com/glossary/trust-irrevocable (last visited May 9, 2022) ("The trustee holds legal title to any assets held in trust while the beneficiaries hold equitable title.").

[56] *See* FLA. STAT. § 736.151(1) (highlighting that a community property trust may continue to qualify as the settlor's homestead). *But see* Rogers, *supra* note 5 (explaining that the homestead exemption remains with the owner and is therefore lost when the property is placed into an irrevocable trust).

[57] *See* FLA. STAT. § 736.151 (referring to trusts vaguely, but not identifying which type). *But see* Joseph B. Colvin, *New Kentucky Community Property Trust Act Provides Incredible Planning Opportunity for Married Couples*, STOLL KEENON OGDEN PLLC (July 21, 2020), https://www.skofirm.com/publications/new-kentucky-community-property-trust-act-provides-incredible-planning-opportunity-for-married-couples/ [hereinafter *Kentucky Community Property Trust Act*] (referring to community property trusts as revocable).

[58] *See Trust, Irrevocable*, *supra* note 55 (noting that in an irrevocable trust, the trustee holds legal title, while the beneficiary holds equitable title); *see also* Kagan, *supra* note 27 (emphasizing that settlors relinquish all legal interest and ownership rights in their assets once they are transferred into an irrevocable trust).

[59] *See* Kagan, *supra* note 27 ("[An irrevocable trust] removes all incidents of ownership, removing the trust's assets from the grantor's taxable estate."); *see also* Suh, *supra* note 33 ("When you transfer your assets into an irrevocable trust, you *relinquish*, or give up, control of them.") (emphasis in original).

[60] *See* S. Walls, Inc. v. Stilwell Corp., 810 So. 2d 566, 570 (Fla. 5th DCA 2002) (citing Bessemer Props., Inc. v. Gamble, 27 So. 2d 832 (Fla. 1946)) ("[T]he individual claiming homestead exemption need not hold fee simple title to the property."); *see also Bessemer Props., Inc.*, 27 So. 2d at 833 (citation omitted) ("This court has also held that a one-half interest, the right of possession, or any beneficial interest in land gave the claimant a right to exempt it as his homestead.").

[61] *See* Engelke v. Estate of Engelke, 921 So. 2d 693, 694 (Fla. 4th DCA 2006) (arguing that the residence was covered by Florida's constitutional homestead protection and could not be used to pay the debts of the estate); *see also* FLA. CONST. art. X, § 4(a) ("There shall be exempt from forced

revocable trust "was owned by a 'natural person' for purposes of the constitutional homestead exemption."[62] Especially, "[b]ecause [the grantor] retained a right of revocation, he was free to revoke the trust at any point in time[;] [a]ccordingly, he maintained an ownership interest in his residence, even though a revocable trust held *title* to the property."[63]

In *In Re Alexander*, the court developed a three-prong test to determine if a property held in a revocable trust may avail itself of the homestead exemption: the individual must (i) "have a legal or equitable interest which gives the individual the legal right to use and possess the property as a residence;" (ii)"have the intention to make the property his or her homestead;" and (iii) "maintain the property as his or her principal residence."[64] If applied to an irrevocable trust, the test found in *In Re Alexander* fails because settlors of an irrevocable trust do not retain either legal or equitable title.[65] Accordingly, settlors of an irrevocable community property trust would not be able to maintain their constitutional homestead exemption because the first prong of the test requires the settlor to have either legal title or equitable interest in the property.[66]

B. THE IMPORTANCE OF CITIZENSHIP IN A COMMUNITY PROPERTY TRUST

The unlimited marital deduction is a tax exemption offered by the IRS that allows couples to make unlimited interspousal transfers of either real property or other assets without incurring tax.[67] In a community property trust, the contribution to the trust by a non-citizen spouse does not qualify for the unlimited marital tax deduction.[68] Not having the ability to benefit from the unlimited

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sale under process of any court, and no judgment, decree or execution shall be a lien thereon . . . the following property . . . .").

[62] *Estate of Engelke*, 921 So. 2d at 696; *see* FLA. CONST. art. X, § 4(a)(1) (stating that homestead "owned by a natural person" is exempt from forced sale, judgments, decrees, and liens).

[63] *Estate of Engelke*, 921 So. 2d at 696; *see Stilwell Corp.*, 810 So. 2d at 570 (quoting *Bessemer Props.*, 27 So. 2d at 833) ("Thus 'a one-half interest, the right of possession, or any beneficial interest in land gave the claimant a right to exempt it as his homestead' . . . .").

[64] *In re* Alexander, 346 B.R. 546, 548 (Bankr. M.D. Fla. 2006); *see In re* Edwards, 356 B.R. 807, 811–12 (Bankr. M.D. Fla. 2006) (concluding that, because the trust settlor satisfied all three prongs of the test in *Alexander*, the property retained its homestead exemption).

[65] *See* Kagan, *supra* note 27 ("Once an asset is transferred to [an irrevocable] trust, it is owned by the trust for the benefit of its beneficiaries."); *see also* Suh, *supra* note 33 (explaining that once a settlor transfers assets to an irrevocable trust, he or she no longer owns those assets).

[66] *See* DeJesus v. A.M.J.R.K. Corp., 255 So. 3d 879, 881 (Fla. 2d DCA 2018) (reasoning that there was no ownership interest, either legal or equitable, where the property at issue was owned by a corporation); *see also For Asset Protection, LLCs and Irrevocable Trusts Have Strategic Roles,* LEGACY ASSURANCE PLAN (Oct. 15, 2019), https://legacyassuranceplan.com/articles/trusts/llc-irrevocable-trust/ ("Like an irrevocable trust, an LLC is viewed as an independent entity under the law.").

[67] *See* Garber*, supra* note 43 ("The [unlimited marital deduction] applies to both estate taxes and gift taxes."); *see also* 26 U.S.C. § 2523(a) (codifying the unlimited allowance of deduction amongst spouses).

[68] *See* Garcia & Wioncek*, supra* note 3 ("If one such spouse is not a United States citizen, then the contribution of separate property by the other spouse would not qualify for the unlimited marital

marital tax deduction may trigger gift taxation.[69] Notably, "[t]he gift tax applies to a transfer by way of gift whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible."[70]

Non-citizens may avail themselves of a $10,000 annual gift exclusion—which is adjusted for inflation on a yearly basis—to transfer a present interest in the property.[71] For instance, Dee, a United States citizen, transfers to Suzy, his spouse, "outright, 100 shares of X Corporation stock valued for federal gift tax purposes at $130,000."[72] That "transfer is a gift of a present interest in property . . . ."[73] Consequently, because the transfer of shares qualifies as a gift, "$10,000 of the $130,000 gift is excluded from the total amount of gifts made during the calendar year by [Dee] for gift tax purposes."[74]

Further, whether the non-citizen settlor triggers a gift tax depends on whether the community property trust is revocable or irrevocable.[75] As previously mentioned, in an irrevocable trust, the settlor relinquishes all ownership rights to an asset, thereby making an outright gift to the trust.[76] In the case of a

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deduction benefit and could trigger a U.S. federal gift tax situation."). *But see* Julia Kagan, *Qualified Domestic Trust (QDOT)*, INVESTOPEDIA, https://www.investopedia.com/terms/q/qualifying-domestic-trust.asp (Mar. 28, 2021) ("A qualified domestic trust (QDOT) allows a non-citizen surviving spouse of a deceased taxpayer to take advantage of the marital deduction on estate tax for any assets that are placed into the trust before the death of the decedent.").

[69] *See* Garcia & Wioncek, *supra* note 3 (noting potential tax consequences associated with creating a community property trust as a non-U.S. citizen); *see also* Kagan, *supra* note 68 ("Normally, a U.S. citizen surviving spouse can take the marital deduction, but a non-citizen surviving spouse cannot.").

[70] 26 C.F.R. § 25.2511-1(a) (2021); *see, e.g.,* 26 U.S.C. §§ 2501, 2511 (containing rules relating to the taxation of property transfers by gift by donors who are non-U.S. citizens).

[71] *See* 26 U.S.C. § 2523(i)(2) (noting that non-U.S. citizen spouses are eligible for a gift tax exclusion of up to $10,000 if the gift otherwise qualifies for the gift tax annual exclusion under section 2503(b)); *see also* 26 U.S.C. § 2503(b)(1) (noting that with the exception of gifts of future interests in property, a gift made by a donor during the calendar year excludes the first $10,000).

[72] 26 C.F.R. § 25.2523(i)-1(d); *see* 26 U.S.C. § 2503(b)(1) (noting that in order for the first $10,000 of a gift to be exempt, it must be a transfer of present possessory interest in property).

[73] 26 C.F.R. § 25.2523(i)-1(d); *see* 26 U.S.C. § 2503(b)(1) (noting that the transfer of interest must be a transfer of present interest).

[74] 26 C.F.R. § 25.2523(i)-1(d); *see* 26 U.S.C. § 2523(a) (discussing the allowance of a deduction in computing taxable gifts between spouses).

[75] *See* Suzanne L. Shier & David Diamond, *Foreign Person's CRECreation ATION of Trusts FForOR U.S. Beneficiaries*, N. TR. 5 (Mar. 2017), https://www.northerntrust.com/documents/white-papers/wealth-management/wealth-planning-insights-frgn-trusts-for-US-benef.pdf (explaining that, when a foreign person desires to make a gift in trust, that trust is designed as an irrevocable trust); *see also* Fanny Karaman et al., *Tax 101: Foreign Settlors, U.S. Domestic Trusts, and U.S. Taxation*, RUCHE L. 22, http://publications.ruchelaw.com/news/2016-08/Tax101_US_Trust_Foreign_Settlor.pdf (last visited May 9, 2022) (noting that a gift of property from a settlor to a trust is considered to be a gift unless the trust is revocable).

[76] *See* Gideon Alper, *Florida Irrevocable Trust*, ALPER L., https://www.alperlaw.com/estate-planning/florida-irrevocable-trust/ (Feb. 11, 2022) ("Transfers of assets to an irrevocable trust are a permanent gift of property for the benefit of other people designated as trust beneficiaries."); *see also Irrevocable Trusts for Estate Tax Planning, Gift Tax And Gifting Strategies Explained*, O'FLAHERTY L. (Nov. 16, 2020), https://www.oflaherty-law.com/learn-about-law/irrevocable-

revocable trust, the settlor still retains a right to control the asset, which would not constitute a gift to the trust because the settlor still retains some ownership rights.[77] Accordingly, a revocable trust proves itself to be the superior option over irrevocable trusts when it comes to community property because it allows for a non-citizen settlor to fund a community property trust while avoiding gift tax taxation.[78]

This issue of gift taxation for non-citizens is fundamental in Florida because of its reputation for being a migratory state.[79] Since mixed-citizenship couples are common in Florida, the government must inform both the citizenry and attorneys of the consequences of forming a community property trust where both spouses are not citizens.[80] After all, the purpose of creating a trust is not to burden the non-citizen spouse, but to make things financially easier for him or her.[81]

C. UNDERSTANDING THE BENEFITS OF A STEP-UP IN BASIS

Residents of community property states may avail themselves of a double step-up basis; however, the same cannot be said for residents of non-community property states that offer their citizens the option to settle a community property

trusts-for-estate-tax-planning-gift-tax-and-gifting-strategies-explained ("Transfers to an irrevocable trust are generally subject to gift tax.").

[77] *See* Julia Kagan, *Settlor Defined Legally*, INVESTOPEDIA, https://www.investopedia.com/terms/s/settlor.asp (Feb. 26, 2021) (explaining that the settlor of a revocable trust retains the right to change and amend the assets and terms of the trust during his or her lifetime). *But see Irrevocable Trusts*, HELSELL FETTERMAN LLP, https://www.helsell.com/faq/irrevocable-trusts/ (last visited May 9, 2022) ("Gifts to an irrevocable trust are treated as gifts to the underlying trust beneficiaries.").

[78] *See Irrevocable Trusts*, *supra* note 77 ("If you transfer over a certain amount [into an irrevocable trust], you will be required to file a gift tax return and may [] have to pay a gift tax on the transfer."); *see also* Shier & Diamond, *supra* note 75 ("A foreign person may desire to make a current gift in trust for U.S. beneficiaries. In that case, the trust is designed as an irrevocable U.S. domestic non-grantor trust.").

[79] *See Immigrants in Florida,* AM. IMMIGR. COUNCIL (Aug. 6, 2020), https://www.americanimmigrationcouncil.org/research/immigrants-florida ("In 2018, 4.5 million immigrants (foreign-born individuals) comprised 21 percent of the [Florida] population."); *see also Florida Ranks #1 in Net Migration for Fifth Consecutive Year,* TAMPA BAY ECON. DEV. COUNCIL (July 27, 2021), https://tampabayedc.com/news/florida-ranks-1-in-net-migration-for-fifth-consecutive-year/ ("For the fifth consecutive year, Florida ranks in the number one spot for net migration.").

[80] *See* Phillip Connor, *Immigration Reform Can Keep Millions of Mixed-Status Families Together*, FWD.US (Sept. 9, 2021), https://www.fwd.us/news/mixed-status-families/ (noting that "more than half of U.S. citizens living in mixed-status households live in" Florida and three other states); *see also* 26 C.F.R. § 25.2503-2 (2021) (noting that the consequence is the imposition of gift tax for assets transferred, with the exception of the first $10,000).

[81] *See Your Spouse,* FIDELITY, https://www.fidelity.com/life-events/estate-planning/beneficiary-strategies/spouse (last visited May 9, 2022) ("A trust can be an effective tool for transferring assets to a spouse while reducing estate taxes and maintaining control over the assets even after you have passed away."); *see also* Julia Kagan, *Marital Trust,* INVESTOPEDIA, https://www.investopedia.com/terms/m/marital-trust.asp (Aug. 15, 2021) (discussing how marital trusts may prevent probate and allow "spouses to pass assets to each other without tax consequences.").

trust.[82] By way of brief explanation, the double step-up in basis is criticized for being a loophole for affluent individuals.[83] For instance, a millionaire who invests in assets such as real estate and stocks will see those assets appreciate.[84] As a result of the appreciation, the investment will produce a consistent rate of return during the investor's lifetime.[85] Therefore, "[t]he investor's heirs will enjoy the benefits of the investment after their death because they will be taxed on the stepped-up cost basis, instead of the original cost."[86]

Throughout the years, "economists have proposed eliminating step-up in basis and have suggested that it could be replaced with lower capital gains taxes."[87] President Biden has proposed an end to the step-up in basis loophole as part of his tax reform plan.[88] President Biden proposes an end to step-up in basis "by ensuring that capital gains are taxed at the time a person gifts or bequeaths an asset to an heir if they have not been taxed already."[89] However, the step-up in basis has received criticism long before President Biden shed light on it.[90]

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[82] *See* Kenton, *supra* note 4 (stating that community property states may avail themselves of the double step-up in basis provision); *see also* Garcia & Wioncek, *supra* note 3 (explaining that community property jurisdictions take advantage of double step-up in basis taxation).

[83] *See* Kenton, *supra* note 4 ("The step-up in basis tax provision has often been criticized as a tax loophole for the ultra-rich and wealthy."); *see also* Joshua Kennon, *What Is a Step-Up in Basis?,* THE BALANCE https://www.thebalance.com/how-the-stepped-up-basis-loophole-works-357485 (Oct. 4, 2021) ("The step-up in basis loophole is a method for bypassing capital gains taxes when an asset is passed on.").

[84] *See* Kenton, *supra* note 4 (illustrating a scenario where a wealthy individual uses the double step-up as a loophole). *See generally* Kennon, *supra* note 83 ("This tax loophole adjusts the tax value of an asset so that if it has appreciated and is sold, there are fewer capital gains to be taxed.").

[85] *See* Kenton, *supra* note 4 (noting that the wealthy investor will most likely be receiving profits from this investment at a steady rate). *See generally* Kennon, *supra* note 83 (illustrating a scenario where "[a person] invested $250,000 over [his or her] lifetime and ended up with $2,710,244 after 40 years. [He or she] passed it on to [his or her] children via [his or her] will[,]" therefore allowing the heirs of these assets to perhaps qualify for a step-up in basis).

[86] *See* Kenton, *supra* note 4 (explaining the way heirs take advantage of the step-up in basis provision); *see also* Kennon, *supra* note 83 ("If you give your heirs shares of appreciated stock or other property while you're alive, they'll inherit your cost basis as if they had been the original purchaser.").

[87] Kenton, *supra* note 4 (explaining the alternative to the step-up in basis that economists are proposing); *see* Kennon, *supra* note 83 ("A report issued by the Joint Committee on Taxation in 2018 found that switching to a carryover basis, rather than a step-up in basis, for inherited assets would increase federal revenue and lower the deficit by $105 billion from 2019 to 2028.").

[88] *See* Kenton, *supra* note 4 (noting that President Joe Biden's newly proposed tax plan proposes revoking the step-up in basis loophole); *see also* Seth Hanlon & Galen Hendricks, *Congress Can't Miss This Chance to Close the Biggest Tax Loophole for the Ultrawealthy,* CAP (Jun. 23, 2021), https://www.americanprogress.org/article/congress-cant-miss-chance-close-biggest-tax-loophole-ultrawealthy/ (noting that capital gains have an unfair advantage in the tax code and President Biden intends to do something about it).

[89] *See* Hanlon & Hendricks, *supra* note 88 (noting that the proposition will ensure that only the wealthy are affected). *See generally* Kennon, *supra* note 83 ("A report issued by the Joint Committee on Taxation in 2018 found that switching to a carryover basis, rather than a step-up in basis, for inherited assets would increase federal revenue and lower the deficit by $105 billion from 2019 to 2028.").

[90] *See* Garcia & Wioncek, *supra* note 3 (explaining that there has been a long debate in the tax field

The effect that the double step-up in basis has on capital gains is quite significant.[91] To illustrate its impact, consider the following example involving a married couple living in a community property state who purchases real property for $10,000.[92] At a subsequent time, the husband passes away, and at that time, the property's fair market value is $110,000.[93] The wife then inherits the property and sells it immediately.[94] In this situation, the wife does not have to pay any capital gains tax because "[b]oth halves of the property receive a step-up in basis to $55,000, its value at the husband's death, so the basis in the property itself is stepped up to its current value [of] $110,000."[95] In contrast, a similar scenario in a non-community property state would result in the wife paying a capital gains tax of about $10,0000 on her half of the property.[96]

The tax privilege of community property states has been under attack since the United States Supreme Court Decision in *Poe v. Seaborn.*[97] In that case, the

as to whether community property trusts in non-community property states are entitled to a double step-up in basis); *see also* Comm'r of Internal Revenue Serv. v. Harmon, 323 U.S. 44, 48 (1944) (holding that an Oklahoma statute that allowed couples to opt-in to a community property regime could not be recognized for federal income tax purposes).

[91] *See Income Tax Advantage of Community Property – "Double Step Up in Basis" Rule,* WASHINGTON (STATE) PROBATE, https://www.avoid-probate.com/double-step-up-in-basis/#Non-Community (last visited May 9, 2022) [hereinafter *Income Tax Advantage of Community Property*] (noting that the step-up in basis rule is the only tax advantage of its sort for a person's estate); *see also* Kenton, *supra* note 4 ("[A] step-up in basis typically minimizes the beneficiary's capital gains tax if and when they dispose of the asset.").

[92] *See Income Tax Advantage of Community Property*, *supra* note 91 (illustrating the double step-up in basis for a married couple in a community property state). *See generally* Jeremy T. Ware, *Section 1014(B)(6) and The Boundaries of Community Property*, 5 NEV. L. J. 704 (2005) (noting that residents of a community property state are entitled to a full step up in basis pursuant to §1014 of the Internal Revenue Code).

[93] *See Income Tax Advantage of Community Property*, *supra* note 91 (noting that the husband must pass away in order for his half to receive a step-up in basis); *see also* Ware, *supra* note 92, at 705 (explaining that appreciation of a decedent's assets in a community property regime almost entirely evades federal income taxation).

[94] *See Income Tax Advantage of Community Property*, *supra* note 91 (highlighting that the wife must quickly sell the property to avoid capital gains tax). *See generally* Ware, *supra* note 92, at 705 (noting that the double step-up provision is the biggest federal tax advatange of a community property state).

[95] *See Income Tax Advantage of Community Property*, *supra* note 91 (illustrating how the double step-up in basis affected the wife's tax liability); *see also* Ware, *supra* note 92, at 705 ("[T]he appreciation on most property passing from decedents entirely escapes federal income taxation.").

[96] *See Income Tax Advantage of Community Property*, *supra* note 91 (explaining that the wife would have to pay about $10,000 in capital gains because the husband's half of the property is the only one that receives a step-up in basis to $55,000 at the time of death, "[t]he wife's half of the property retains its original cost basis of $5,000[,]" and "[t]he wife realizes a gain of $50,000 (ie, $110,000 fair market value – $60,000 ($55,000 from husband and $5,000 from wife) combined basis)." The wife pays a maximum capital gains tax on 20% of the $50,000.); *see also* Ware, *supra* note 92, at 705 ("Usually, when spouses own a piece of property jointly and one of them dies, only the decedent's half of the property would be stepped up.").

[97] *See* Franklin C. Latcham, *Invasions of the Community Property Income Tax Privileges*, 20 WASH. L. REV. & ST.B.J. 44 (1945) (explaining that the court's holding in Poe v. Seaborn trigerred other courts to want to overrule the tax benefit that Poe v. Seaborn upholds); *see also* Poe v. Seaborn*,* 282 U.S. 101, 117 (1930) (affirming the District court's decision because "[it] was right in holding that

court reasoned that because the wife had an interest in half of the community property jointly owned with her spouse, she could file a separate tax return on only half of all the income earned by the community property.[98] However, in 1944 the Supreme Court in *Commissioner v. Harmon* refused to allow a married couple that created a community property trust under the laws of Oklahoma to divide their community income equally for federal income tax purposes.[99] As a result of the decision in *Harmon*, states like Alaska, Tennesse, South Dakota, Kentucky, and now Florida, do not have the benefit of a double step-up in basis.[100]

In *Harmon,* the court distinguished a consensual community from a legal community by noting that "a consensual community arises out of contract."[101] In contrast, a legal community arises out of state law upon marriage.[102] The distinction between a consensual and a legal community is responsible for the difference in tax treatment between community property states and common law states that allow community property trusts.[103] The IRS adopted the reasoning in *Harmon* in the Internal Revenue Manual ("IRM") by implementing provisions that support it, such as IRM § 25.18.1.2.2, which states that "[t]he U.S. Supreme Court ruled that a similar statute allowing spouses to elect a community property system under Oklahoma law would not be recognized for federal income tax reporting purposes[;] [therefore] [,] [t]he *Harmon* decision should also apply to the Alaska system for income reporting purposes."[104]

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the husband and wife were entitled to file separate returns, each treating one-half of the community income as his or her respective incomes, and its judgment is affirmed.").

[98] *See Poe*, 282 U.S. at 113 (reasoning that because the law vests power in the husband, does not mean that the wife cannot have the same power); *see also* Latcham, *supra* note 97, at 44 ("[B]ecause under the local law of Washington a wife had a vested interest in one half of the community property she could therefore file a separate return on one half of all income earned by the community.").

[99] *See* Latcham, *supra* note 97, at 44 (explaining the facts of that case); *see also* IRM 25.18.1.2.2 (March 4, 2011) (noting that because of the decision in *Commissioner v. Harmon* non-community property systems are not recognized for federal income tax purposes).

[100] *See* IRM § 25.18.1.2.2 ("The Harmon decision should also apply to the Alaska system for income reporting purposes."); *see also Income Tax Advantage of Community Property, supra* note 98 (explaining that the double step-up in basis is an income tax advantage offered only to those married couples in community property states).

[101] *See* Comm'r of Internal Revenue Serv. v. Harmon, 323 U.S. 44, 47 (1944) (explaining that non-community property states are treated as consensual regimes); *see also* Ware, *supra* note 92 (analyzing the court's reasoning in *Lucas v. Earl* on consensual and legal regimes).

[102] *See Harmon*, 323 U.S. at 47 (explaining that legal community property systems inherited their character from Spanish law); *see also* Ware, *supra* note 92, at 727 ("In Harmon, the Court found Oklahoma's elective regime to be more like *Lucas v. Earl*, and thus it was not a valid community property system for purposes of the federal income tax.").

[103] *See* Ware, *supra* note 92, at 727 ("The automatic nature of traditional community property regimes is the key to their validity for federal income tax purposes, concerning the splitting of income."); *see also* IRM § 25.18.1.2.2 (noting that the decision in *Harmon* governs for federal income tax purposes).

[104] *See* IRM § 25.18.1.2.2 (noting that "each spouse owns an automatic 50% interest in all community property, regardless of which spouse acquired the community property"). *See generally* Garcia & Wioncek, *supra* note 3 ("[T]here has been debate within the tax field (without an ultimate consensus), as to whether community property trusts settled in a non-community property state such as

Florida is a consensual community that allows its residents to form community property trusts.[105] Pursuant to Section 736.1511 of the Florida Statutes titled "Application of Internal Revenue Code; community property classified by another jurisdiction," a community property trust "is considered a trust established under the community property laws of the state."[106] However, the CPTA does not refer to the IRS's treatment of community property established in a consensual community regime.[107] Awareness of this tax treatment is vital for Florida residents because community property generally stands out because of its double-step up basis.[108] Florida's community property trust settlors deserve transparency and clarity concerning all matters related to their newly formed trusts.[109]

IV. SOLUTIONS

A. WHY AN IRREVOCABLE TRUST SHOULD NOT BE AN OPTION FOR HOMESTEAD PROPERTY

To prevent irrevocable community property trusts from becoming a problem in Florida, Florida legislators should amend the statute to suggest revocable trusts as the only option for community property.[110] Alternatively, community

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Florida are, in fact, entitled to the double basis adjustment.").

[105] *See Harmon*, 323 U.S. at 47 (explaining that states that are not community property but instead allow agreements that characterize property as community property are treated as consensual regimes); *see also* Garcia & Wioncek, *supra* note 3 (explaining that Florida allows you to opt-in to a community property treatment).

[106] *See* FLA. STAT § 736.1511 (making reference to section 1014(b)(6) of the Internal Revenue Code, which allows devises of community property upon death of one spouse); *see also* Garcia & Wioncek, *supra* note 3 ("The CPTA has a specific provision expressly providing that a community property trust is to be treated as a trust established under the community property laws of a state.").

[107] *See* § 736.1511 ("[A] community property trust is considered a trust established under the community property laws of the state."); *see also* Garcia & Wioncek, *supra* note 3 (noting that the uncertainty behind how the IRS will treat Florida's CPTA is vital for trust settlors).

[108] *See* T. John Costello, Jr., *What to Know About Community Property Trust (CPT) Option in Florida* (Oct. 5, 2021, 6:01 A.M..), https://www.naplesnews.com/story/sponsor-story/naples-trust-company/2021/10/05/what-know-community-property-trust-cpt-option-florida/5995210001/ ("[P]ractitioners believe that because these trusts allow Florida residents to 'opt-in' to community property, there is a risk that the IRS will challenge them in the future and attempt to limit the basis adjustment to only 50% of the trust's property."); *see also Florida Creates "Community Property" Opportunity*, *supra* note 2 ("Community property enjoys a significant income tax benefit because upon the death of the first spouse, federal laws provide that the cost basis of 100% of the community property is adjusted to the fair market value of the property as of the date of death.").

[109] *See Florida Creates "Community Property" Opportunity*, *supra* note 2 (explaining the impact that Florida's CPTA will have on Florida's legal profession and real estate market); *see also* Garcia & Wioncek, *supra* note 3 (noting several potential issues with Florida's CPTA).

[110] *See Kentucky Community Property Trust Act, supra* note 56 (explaining that a community property trust typically replaces or supplements a couple's revocable trust). *But see* Dan Holbrook, *Community Property Trusts*, TENN. BAR ASS'N (Nov. 16, 2010), https://www.tba.org/index.cfm?pg=LawBlog&blAction=showEntry&blogEntry=9527 (explaining that the Tennesssee Community Property Trust act also provides settlors the option of creating either a revocable or irrevocable trust).

property trust settlors can eliminate the risk of losing their homestead exemption by abstaining from creating an irrevocable trust.[111] By creating a revocable trust instead of an irrevocable trust, settlors also allow their beneficiaries to receive a homestead exempted property.[112]

B. CREATING A COMMUNITY PROPERTY TRUST—CITIZENSHIP COUNTS TOO

Remarkably, the CPTA does not refer to the issue of non-citizens funding a community property trust.[113] The absence of a provision addressing tax liability for non-citizens in the CPTA could increase litigation in Florida.[114] To avoid a voluminous amount of litigation and unsatisfied trust settlors, the IRS must adopt a tax exemption for those non-citizen settlors that transfer assets into a community property trust.[115] The IRS already has an exemption for gifts by non-citizens of up to $10,000; indicating their willingness to shield non-citizens

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[111] *See* Rogers, *supra* note 5 (noting that the homestead exemption remains with the owner and once the homestead property is funded into an irrevocable trust, the homestead exemption is lost). *But see* Julia Kagan, *Qualified Personal Residence Trust (QPRT)*, INVESTOPEDIA, https://www.investopedia.com/terms/q/qualified-personal-residence-trust.asp (Aug. 3, 2021) (explaining that a QPRT "is a specific type of irrevocable trust that allows its creator to remove a personal home from their estate for the purpose of reducing the amount of gift tax that is incurred when transferring assets to a beneficiary"). *Contra* Fetterman, *supra* note 77 ("One of the main disadvantages of a QPRT is the loss of stepped-up basis.").

[112] *See* FLA. CONST. art. X, § 4(b) ("These exemptions shall inure to the surviving spouse or heirs of the owner."); *see also* Kagan, *supra* note 27 ("When using revocable trusts government entities will consider that any property held in one still belongs to the trust's creator . . . .").

[113] *See* Garcia & Wioncek, *supra* note 3 ("If one such spouse is not a United States citizen, then the contribution of separate property by the other spouse would not qualify for the unlimited marital deduction benefit and could trigger a U.S. federal gift tax situation."); *see also United States: To Trust or Not to Trust- Florida's New Statutes Pave the Way for Expansion of Individual's Succession Planning Opportunities,* BAKER MCKENZIE (Aug. 26, 2021), https://insightplus.bakermckenzie.com/bm/tax/united-states-to-trust-or-not-to-trust-floridas-new-statutes-pave-the-way-for-expansion-of-individuals-succession-planning-opportunities ("If one spouse is not a U.S. citizen, however, then the contribution of separate property by the other spouse would not qualify for the unlimited marital deduction benefit and could trigger a U.S. federal gift tax situation.").

[114] *See* Bob Carlson, *The Gift Tax Return Trap And How To Avoid It,* FORBES (Oct. 23, 2018), https://www.forbes.com/sites/bobcarlson/2018/10/23/the-gift-tax-return-trap-and-how-to-avoid-it/ ("The IRS realized a few years ago that people weren't filing gift tax returns when they were required to. So, it began clamping down on unfiled gift tax returns by searching for gifts that should have been reported."); *see also* Katherine Davis, *How Does The IRS Know If You Give a Gift?*, TAXRY, https://www.taxry.com/blog/irs-know-you-give-gift (June 6, 2021) (explaining that not report a gift to the IRS could lead to penalties and interest).

[115] *See Estate Planning for Non-US Citizens*, DROBNY L. OFFS., https://www.drobnylaw.com/articles/estate-planning-for-non-us-citizens (last visted Apr. 30, 2022) ("[I]f the 'receiving' spouse is not a US citizen or US resident, the IRS requires special provisions to be included in the revocable trust for the unlimited marital deduction to apply."); *see also Some Nonresidents with U.S. Assets Must File Estate Tax Returns,* IRS, https://www.irs.gov/individuals/international-taxpayers/some-nonresidents-with-us-assets-must-file-estate-tax-returns (last visited May 9, 2022) (noting that non-citizens are treated to the same standard as citizen tax payers, that standard being to timely file taxes).

that transact in the United States.[116] By Florida taking the initiative to create a tax shield for non-citizen settlers, other states that offer a CPTA would reap the benefits by having another state set a precedent.[117]

C. THE FIGHT FOR A STEP-UP IN BASIS

As a solution, I propose clarity in the law as it refers to this issue by implementing a provision in the CPTA that delineates its tax treatment pursuant to *Harmon*.[118] The CPTA's vague provision concerning its tax treatment does not offer transparency to its reader, resulting in unsatisfied trust settlors and frustrated legal professionals.[119] The proposed provision can simply refer to *Harmon* and provide a brief explanation about its tax impact.[120] Further, readers of the CPTA could benefit from an explanation of the difference between a consensual community and a legal community.[121]

V. CONCLUSION

While the CPTA adds great value to Florida's estate planning realm, it could benefit from less ambiguity.[122] As previously discussed, the CPTA's

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[116] *See* 26 U.S.C. § 2503(b)(1) (2021) (noting that the first $10,000 (this number is adjusted for inflation yearly) of a gift that transfers present interest will be excluded from gift taxation); *see also* Shier & Diamond, *supra* note 75 (noting that the gift tax also does not apply to intellectual property).

[117] *See* T. John Costello, Jr., *Florida Creates Community Property Opportunity,* TAMPA BAY BUS. J. (Oct. 14, 2021), https://www.sancaptrustco.com/florida-creates-community-property-opportunity/ ("Florida has now joined Alaska, Tennessee, South Dakota and Kentucky to become the fifth state to provide its citizens with the opportunity to create community property trusts."); *see also Laws Governing the Initiative Process in Florida,* BALLOTPEDIA, https://ballotpedia.org/Laws_governing_the_initiative_process_in_Florida (last visited May 9, 2022) (explaining that Florida has a system in place for new laws to be proposed on voting ballots).

[118] *See* § 25.18.1.2.2 (stating that "[t]he Harmon decision should also apply to the Alaska system for income reporting purposes[,]" and although Florida and Alaska do not have identical statutes, they are quite similar and Florida's CPTA will most likely be treated just as Alaska's system); *see also* Ware, *supra* note 92, at 726 ("The question in Harmon was whether such an elective regime was more like a typical community property regime, which validly splits income . . . .").

[119] *See* FLA. STAT. § 736.1511 (2021) ("For purposes of the application of s. 1014(b)(6) of the Internal Revenue Code of 1986, 26 U.S.C. s. 1014(b)(6), as of January 1, 2021, a community property trust is considered a trust established under the community property laws of the state."); *see also Florida Creates "Community Property" Opportunity*, *supra* note 2 ("[S]ome practitioners believe that because these trusts allow Florida residents to 'opt-in' to community property, there is a risk that the IRS will challenge them in the future and attempt to limit the basis adjustment to only 50% of the trust's property.").

[120] *See* Ware, *supra* note 92, at 725 (explaining that in an elective community property regime the IRS will not consider it community property for purposes of federal income tax); *see also* Garcia & Wioncek, *supra* note 3 (citing to *Harmon* in order to highlight the uncertainty behind federal income taxation in elective community property states).

[121] *See* Ware, *supra* note 92, at 726 (explaining that the distinction arose out of the case of *Lucas v. Earl*); *see also* Latcham, *supra* note 97, at 46 (explaining that a consensual system is created by a states' contract law whereas a legal system is dictated by state policy as an incident of marriage).

[122] *See Florida Creates "Community Property" Opportunity*, *supra* note 2 (explaining the impact that Florida's CPTA will have on Florida's legal profession and real estate market); *see also* Garcia & Wioncek, *supra* note 3 (noting several potential issues with Florida's CPTA).

misleading flaws can be redressed by an amendment to the statute or by favorable exemptions to the IRS.[123] Trust settlors and legal professionals alike deserve a clear interpretation of the statute; therefore, it is incumbent on the state legislators to remedy the aforementioned issues.[124]

[123] *See Florida Creates "Community Property" Opportunity*, *supra* note 2 ("[S]ome practitioners believe that because these trusts allow Florida residents to 'opt-in' to community property, there is a risk that the IRS will challenge them in the future and attempt to limit the basis adjustment to only 50% of the trust's property."); *see also* Garcia & Wioncek, *supra* note 3 ("The CPTA has a specific provision expressly providing that a community property trust is to be treated as a trust established under the community property laws of a state.").

[124] *See Florida Creates "Community Property" Opportunity*, *supra* note 2 (explaining the impact that Florida's CPTA will have on Florida's legal profession and real estate market); *see also* Garcia & Wioncek, *supra* note 3 (noting several potential issues with Florida's CPTA).