

Developments in Florida trust law

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This update summarizes four new laws enacted in Florida that could be of interest for Florida clients' estate and tax planning.

There are four updates to Florida law that clients should be aware of for estate and tax planning purposes: Florida's extension of its rule against perpetuities period to 1,000 years; the passage of the Community Property Trust Act allowing married couples to opt to receive community-property treatment for assets held in a qualifying trust; an amendment that affects Florida Spousal Limited Access Trusts (SLATs) which might allow a SLAT donor to potentially become a beneficiary of the SLAT; and the passage of the Florida Uniform Directed Trust Act (FUDTA) defining the responsibilities of trust directors and directed trustees. This client update provides an overview of these developments in Florida law, as well as some cautions of which clients should be aware before taking advantage of them.

Rule against perpetuities period extended

In May 2022, Florida amended its statutory rule against perpetuities period, the maximum permitted duration of a Florida trust, from 360 to 1,000 years. Under the new law, an interest in any trust created on or after July 1, 2022 must vest within 1,000 years of that interest's creation. Florida had previously extended its perpetuities period from 90 to 360 years, effective for trusts created between January 2001 and June 2022.

Community Property Trust Act enacted

Effective July 1, 2021, Florida's Community Property Trust Act (CPTA) allows married couples to hold assets in a community property trust and enjoy a significant benefit of community property—a full step-up in basis for property held in the trust upon the death of a spouse—despite Florida being a separate property state.

Generally, the donee of an asset received through inheritance enjoys a step-up in tax cost basis to the fair market value of the asset as of the date of the donor's death. In Florida, a separate property state, married couples can jointly own property as "joint tenants with right of survivorship" or "tenants by the entirety." Upon the death of a spouse, a surviving spouse inherits the decedent's one-half share of jointly-owned property, and receives a basis adjustment for only that one-half share of the property. In a community property jurisdiction, by contrast, upon the death of a spouse the entire community property owned by a couple will generally receive a step-up in basis to the fair market value – that is, both the decedent spouse's share and the surviving spouse's share. Clients may be able to take advantage of this tax benefit by holding assets in a Florida Community Property Trust (FLCPT), under which each spouse holds a one-half interest in the trust's assets and the trust assets receive community property treatment.

There are five requirements for a couple to establish a valid FLCPT. First, the trust must expressly state that it is a community property trust within the meaning of the CPTA. Second, the trust must have at least one trustee who is either a Florida resident or a banking institution authorized to conduct business in Florida. Third, the trust instrument must be signed by both settlor spouses. Fourth, the trust must contain express language, provided in the act, stating the potential consequences of establishing a community property trust. Fifth, the settlor spouses must be the only qualified beneficiaries of the trust while both are living. Once the trust is properly set up, the property transferred to it will be classified as community property.

Despite the apparent benefits of a FLCPT, clients should consider the following cautions. First, the IRS has not addressed whether it would permit a full step-up in basis for property in a trust that grants community property treatment to individuals who do not live in a community property state.

Second, the effectiveness of the full step-up in basis may depend on how and when property is converted to community property through an FLCPT. If one spouse contributes separate property to a FLCPT, thus converting it to community property, and the non-transferring spouse dies within one year of the conversion, provisions in the Internal Revenue Code may limit the applicability of the basis adjustment for the property so contributed.

Third, unlike for property jointly owned by a married couple as tenants by the entirety, community property does not provide an automatic right of survivorship. Each spouse may freely dispose of his or her one-half interest in community property by will or trust.

Fourth, placing property in an FLCPT comes with certain asset protection limitations. While property owned as tenants by the entirety cannot generally be reached by either spouse's creditors, creditors of one spouse can reach that spouse's one-half interest in property held in an FLCPT.

Lastly, because spouses have equal rights to community property, converting property that is currently separate property to community property may give a formerly non-propertied spouse rights to that property for personal use and rights over that property in divorce.

Florida Uniform Directed Trust Act enacted

Also in 2021, Florida enacted the Florida Uniform Directed Trust Act (FUDTA), which expands Florida's directed trust laws and more clearly defines the duties and liabilities of trust directors and directed trustees of Florida trusts. While the new law became effective on July 1, 2021, it applies to the actions of any trust director, even for trusts created before the effective date.

A directed trust allows a grantor to appoint trustees to manage the administration of a trust and to appoint a third-party trust director to direct the trustees with respect to certain trustee discretions – such as the investment management of trust assets or trust distributions. Directed trusts can result in reduced trustee fees and greater flexibility in the administration of a trust. For example, a directed trusteeship may be helpful in the context of a trust which holds family business interests. The trustee can be directed on business related decisions by a director who knows the business best, while allowing the trustee to exercise discretion over other trust administration matters.

The FUDTA prevents trust directors from also acting as trustees, and subjects trust directors to the same fiduciary duties as trustees: to act in good faith and in the interest of a trust's beneficiaries. FUDTA also limits the liability of directed trustees, requiring directed trustees to act reasonably in accordance with the directions of a trust director. Directed trustees are only liable if such action constitutes willful misconduct.

Florida Spousal Limited Access Trusts (SLATs)

Florida has amended its laws to expand creditor protection for so-called "spousal limited access trusts" (SLATs) under certain circumstances. The amended law is effective for SLATs created on or after July 1, 2022.

As we have explained in previous client updates, a SLAT is an irrevocable trust created by one spouse for the benefit of the other spouse (which can and often does also include other beneficiaries, such as descendants). Such trusts can be used to make gifts sheltered by the Federal gift tax exemption. For clients who wish to take advantage of the temporarily increased Federal gift tax exemption amount (currently \$12,060,000 per donor) before it decreases at the end of 2025 (or by sooner tax legislation) but feel some financial insecurity in making a large gift, using a SLAT can provide the grantor with indirect access to the trust assets by virtue of distributions made to the beneficiary spouse during the marriage.

Traditionally, unless a SLAT were established in an asset protection jurisdiction, the grantor could not become a beneficiary after the grantor's spouse's interest ended because to do so would subject the trust assets to the claims of the grantor's creditors and the trust assets would be includible in the grantor's estate for Federal estate tax purposes.

This amended Florida law now provides that if a Florida resident establishes a SLAT under Florida law that complies with the three requirements listed below, the grantor could potentially become a beneficiary after the death of the grantor's spouse without exposing the trust assets to the claims of the grantor's creditors (with some exceptions).

The three requirements for a Florida SLAT are:

1. The grantor cannot be a beneficiary of the SLAT until after the death of the grantor's spouse for whom the SLAT was established.
2. The grantor's spouse for whom the SLAT was established must remain a beneficiary of the SLAT for such spouse's lifetime.
3. Transfers to the trust by the grantor must be considered completed gifts under the Internal Revenue Code.

While the new law allows for some creditor protection for Florida SLATs, there are planning limitations and tax risks that should be explored before setting up a Florida SLAT. For example, because the spouse must remain a trust beneficiary of the SLAT until his or her death, planning in the event of a divorce is foreclosed.

The lawyers listed below are not admitted to practice in Florida, and the matters presented should not be relied upon as legal advice.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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