The Florida Estate Tax: Beware the Nuances

Practitioners should coordinate payment of Florida estate tax with the federal estate tax payments, and understand the interplay between federal and state taxes via extensions

by Louis S. Harrison and John M. Janiga

The Florida estate tax[1] imposes a tax upon the transfer of estates of both resident and nonresident decedents. On its face, the tax appears straightforward and, in effect, has represented a fair death tax approach. Nevertheless, the Florida estate tax contains unexpected nuances.

This article initially provides an overview of Florida estate tax mechanics.[2] Then, it examines the need for sensitivity to the tax in drafting estate planning documents and paying the tax due.

How the Florida Estate Tax Works

The key feature of the Florida estate tax is that it is determined by reference to §2011 of the Internal Revenue Code. That section provides a credit in determining federal estate tax due for "the amount of any estate, inheritance, legacy, or succession taxes *actually paid* to any State or the District of Columbia, in respect of any property included in the gross estate . . ." (emphasis added).[3]

Importantly, the credit will be allowed only to a specified limit, and then only to the extent that Florida estate tax has actually been paid. The starting point for computing the limit is the "taxable estate," which is the federal gross estate minus allowable deductions. From the taxable estate, $60,000 is then deducted to arrive at the "adjusted taxable estate." Finally, based on this amount, the table set forth in Code §2011(b) is used to arrive at what is known as the "maximum credit amount" allowed.

The following schedule illustrates the computation of the maximum state death tax credit amount (note: the taxable estate amount is assumed):[4]

Taxable estate	$ 2,100,000
- Reduction amount	60,000
Adjusted taxable estate	$2,040,000
Maximum credit amount (based on table in §2011(b)):	$106,800

Although the Florida estate tax can never exceed the maximum credit amount allowable on the federal estate return, it may in certain cases be less. This depends on several factors, including the decedent's residency at time of death and the situs of the decedent's property.

If at the time of death the decedent was a resident of Florida, the Florida estate tax is imposed on all of the decedent's property except real estate and tangible personal property located in another state.[5] The Florida estate tax would equal the maximum state death tax credit allowable, but reduced by death taxes paid to other states.[6]

If at the time of death the decedent was a resident of the United States[7] but not a resident of Florida, the Florida estate tax is imposed on the decedent's real estate and tangible personal property with an actual situs in Florida, intangible personal property having a business situs in Florida, and securities or obligations (*e.g.*, stocks, bonds, notes) of Florida corporations.[8] The Florida estate tax would be the maximum state death tax credit allowable, multiplied by a fraction, the numerator of which is the value of the property taxable in Florida and the denominator of which is the value of the decedent's gross estate.[9]

Drafting Estate Planning Documents

One objective of estate planning is to reduce a married couple's overall exposure to federal and state death taxes. Given this objective, estate planners have developed drafting strategies based on the state death tax credit. These strategies revolve around the interplay between state death taxes and credit shelter/marital deduction formulae.

• *Credit Shelter/Marital Deduction Formulae*

Credit shelter/marital deduction formulae provide the vehicle by which estate planners can implement a married couple's objective of minimizing death taxes. The formulae represent the critical aspect of a tax minimization plan which examines the death taxes which will be due at two future points in time, initially at the first spouse's death, and subsequently at the surviving spouse's death.

In the majority of situations, the

plan includes consideration of a federal estate tax credit known as the "unified credit," and the marital deduction. The unified credit of $192,800[10] effectively shields transfers on up to $600,000 from federal estate tax; the marital deduction allows a decedent to transfer an unlimited amount of property to a surviving spouse free of federal estate tax.[11]

The typical plan focuses on eliminating federal estate tax at the first spouse's death[12] by: 1) carving out of such decedent's estate a "credit shelter share" to take advantage of the unified credit, and 2) leaving the remaining share of the estate to the decedent's surviving spouse to qualify for the marital deduction.[13]

Thus, the critical aspect for successful implementation of a tax minimization plan focuses on the credit shelter share—and the formula used to determine it—established under the estate planning documents. The formula is what determines the amount of property which will pass to the credit shelter share.

Significantly, although the unified credit effectively shields transfers of up to $600,000 from federal estate tax, that does not mean that the credit shelter share formula should be drafted to automatically equal $600,000. Rather, the credit shelter share formula has to take into account that this $600,000 amount may be reduced or increased based on several variables, including the state death tax credit.[14]

• *Reference to Florida Estate Tax in Credit Shelter/Marital Deduction Formulae*

The practitioner should consider whether the particular formula used for calculating the credit shelter share should reference the Florida estate tax. Since the amount of the Florida estate tax generally will equal the state death tax credit, any such reference will actually be to the state death tax credit.

Sample credit shelter formulae include: 1) "the maximum amount of property that will result in no increase in federal estate tax payable because of credits and deductions (other than the marital deduction) allowed to my estate," 2) "after considering all deductions and credits available to my estate, the amount necessary to increase my taxable estate to the largest amount that will result in no (or the minimal) payment of federal estate tax," and 3) "the largest amount that can pass free of the payment of any estate tax by reason of credits allowable to my estate." Since the term "credit" as used in these formulae includes not only the unified credit but also the state death tax credit, this reference may unintentionally increase the Florida estate tax paid.

The following example illustrates this situation. Assume these facts: 1) decedent Jane Wilson died a resident of Florida owning property with only a Florida situs; 2) Jane's will left all of her property to her husband, Jack Wilson, via a formula provision which provided that the credit shelter share was to be the largest amount of property which would result in no increase in federal estate tax payable because of the unified credit *and the state death tax credit allowable* to Jane's estate; 3) Jane made no lifetime taxable gifts; and 4) all debts and expenses of Jane's estate are taken and allowed as deductions on the federal estate tax return.

What is the largest amount of property which would result in no increase in federal estate tax payable? On these facts, if the credit shelter share were funded with $600,000, the tentative federal estate tax on this amount would be $192,800.[15] Because of the $192,800 unified credit, no tax would be payable. This result ignores, however, the mandate of the formula to consider not only the unified credit but also the state death tax credit. To account for the state death tax credit, the credit shelter share initially would need to be increased to $642,425. This would increase the tentative federal estate tax by $15,697, to $208,497.[16] Despite the increase, there still would be no federal estate tax payable (and, accordingly, "no increase in federal estate tax payable"). The tentative tax would be offset by $192,800, the unified credit, and $15,697, the state death tax credit on $642,425.[17]

The state death tax credit, however, will only be available if the $15,697 of state death taxes are actually paid. Because payment of the state death taxes must be from the credit shelter share,[18] the credit shelter share would need to be adjusted from $642,425 to account for $15,697 of state death taxes paid.

Jane's formula, therefore, results ultimately in a $626,728 credit shelter share. This produces the following positive effects: 1) The marital share is decreased by $42,425, thereby preventing the future payment of federal estate tax on this amount, and 2) the credit shelter share is increased by $26,728; that amount, plus any appreciation and income, escapes federal

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estate tax at Jack's death.

A negative effect is that state death taxes of $15,697 must be paid at Jane's death. Importantly, these state death taxes, if not then paid, might have been potentially eliminated, decreased, or at minimum, deferred had the credit shelter share not required consideration of the state death tax credit. For example, in the case of a surviving spouse with no taxable estate, no state or federal death taxes would have to be paid. Accordingly, payment of state death taxes at the first spouse's death is unnecessary. Different conclusions may obtain in the case of a surviving spouse with a taxable estate.

If the surviving spouse's maximum marginal federal estate tax is 37 percent, then the payment of state death taxes at the first spouse's passing results in no overall death tax savings.[19] In contrast, if the surviving spouse has a taxable estate subject to federal estate tax at a rate in excess of 37 percent, then the payment of state death taxes equal to $15,697 at the first spouse's passing decreases the federal estate tax payable at the surviving spouse's death.[20] Nevertheless, the tax savings are not substantial. As a result, when drafting under the Florida estate tax scheme, estate planners may reference in the formula that determines the credit shelter share the state death tax credit, but should add the following type of clause: *"provided, however, that consideration of the state death tax credit does not increase or cause the payment of state death taxes."* Retaining the reference to the state death tax credit (with the proviso in italics above), will protect the draftsperson in the event a client owns property or dies in a state other than Florida, and that the other state imposes an estate tax not tied solely to the state death tax credit.

Nevertheless, in those cases in which clients do change domicile from Florida, the practitioner should review the new state's death tax laws. For example, in states which impose state death taxes, even if there is no federal estate tax due, the estate of the first spouse to die may want to take advantage of the maximum state death tax credit that will result in the payment of no federal estate tax, even though this may increase state death taxes paid. In that event, the above proviso should not be included in the credit shelter formula. In making that determination, the increase in state death taxes must be compared with the anticipated decrease in federal estate tax at the surviving spouse's death. Based on this analysis, estate planners can determine the appropriateness of the above proviso in the credit shelter share formula.

Payment of Florida Estate Tax

Generally, the payment of Florida estate tax and the filing of the Florida estate tax return must occur concurrently. An extension, however, can be granted for one and not the other.

Payment of the Florida estate tax and filing of the return is often coordinated with payment and filing of the federal tax and return.[21] Accordingly, because the federal return is due nine months after date of death (assuming no extensions), the Florida estate tax return is also due at that point. If an extension is granted to file a federal return, the Florida return need not be filed until that extended date.[22] Similarly, if an extension of time is granted to pay the tax by the Internal Revenue Service, the time to pay the Florida estate tax is also extended. The Florida estate tax payment extension, however, is limited to one year. Other extensions may be granted, but the aggregate of extensions may not exceed 10 years.[23] With an extension of time to pay, interest is charged on the unpaid Florida estate tax amount at a rate of one percent per month.[24]

Accordingly, because the federal return is due nine months after the date of death (assuming no extensions), the Florida estate tax return is also due at that point

Prior to making an extension request, the practitioner should consider the impact that the timing of state death tax payments will have on the availability of the state death tax credit.[25] If the federal estate tax is paid in one lump sum (not in installments), it will be advantageous to pay Florida state death taxes on or before the filing of the federal estate tax return and use the credit as an offset against federal estate tax then owed. This result occurs because Florida imposes interest on extended state death tax payments.[26] Accordingly, the practitioner should not request an extension for payment of Florida estate tax in that situation because from an overall economic perspective state death taxes should be paid on or before the date of payment of the federal estate taxes.

The most difficult interplay between the federal estate tax payments and Florida estate tax payments occurs if the estate elects installment treatment under Code §6166 and, at the same time, requests an extension or multiple extensions to pay the Florida estate tax. This scenario adds substantial complication to calculation of both the federal and state death tax. Consider, for example, what happens each year as installment payments are made on the federal estate tax. Under Code §6166, interest is paid on the federal unpaid balance. The interest generates a deduction, which reduces the taxable estate.

Because the taxable estate is reduced, so is the amount of the state death tax credit. This means that future payments owed to the State of Florida, as well as past interest paid on the unpaid balance, must be changed. This then has an impact on the future federal estate tax due.

These situations require a complex analysis to determine whether it is economically desirable to pay Florida estate tax via an extension. This analysis requires a comparison of the rate of return that can be received on the unused amounts necessary to make the remaining Florida estate tax payments versus the federal interest which is in effect charged on this unpaid portion.[27]

This comparison is complicated by one other consideration. The federal interest paid is an estate tax deduction.[28] That deduction decreases both the taxable estate and the amount of interest that has accrued to that point and, therefore, the amount of the remaining installment payment obligation.[29]

Although these variables are complex and interrelated, one rule of thumb is that deferral of the payment of state death taxes will make sense from an economic standpoint partly if there is no interest owed on the unpaid state death tax balance and if the deferred amounts (which will be used to make state death tax payments) can be invested in a vehicle which will experience a reasonable return and growth rate. Because Florida imposes interest of one percent per month on its unpaid death tax balance, it is difficult without a computer program to compare the economic benefits of deferral versus lump sum payment of Florida estate taxes, although lump sum payment will certainly be more administratively convenient.[30]

Conclusion

Practitioners must consider the Florida estate tax in drafting estate planning documents. Moreover, in determining when and how to pay the Florida estate tax due, practitioners should carefully coordinate payment with the federal estate tax payments, and should understand the complex interplay between payment of both federal and state death taxes via extension. ❒

[1] FLA. STAT. ANN §198.01, *et seq.* (West 1993).

[2] FLA. STAT. Ch. 198 is entitled "Estate Taxes." This chapter imposes two types of tax, an estate tax and a generation-skipping transfer tax. Only the estate tax is examined in this article.

[3] I.R.C. §2011(A).

[4] I.R.C. §2011(b).

[5] FLA. STAT. ANN §198.02 (West 1993). Although §198.02 does not specifically exempt a decedent's real or tangible personal property located in another state from the Florida estate tax, it is settled constitutional authority that such property may be taxed only by the state of its situs. *See, e.g., Treichler v. Wisconsin*, 338 U.S. 251 (1949).

[6] FLA. STAT. ANN §198.02 (West 1993).

[7] The Florida estate tax imposes a tax upon the transfer of the estates of individuals who are not residents of the United States at the time of death. FLA. STAT. ANN §198.04 (West 1993). This article does not address this issue.

[8] FLA. STAT. ANN §198.03 (West 1993).

[9] *Id.*

[10] I.R.C. §2010(a).

[11] I.R.C. §2056(a).

[12] In large estate situations, it may be worthwhile to incur some federal estate tax at the first spouse's passing in order to take advantage of the graduated federal estate tax rates.

[13] A plan which left all of a decedent's estate to the surviving spouse would also eliminate federal estate tax at the first spouse's death due to the unlimited marital deduction. Such a plan, however, would fail to minimize the couple's overall death taxes because it would waste one spouse's unified credit. Under that plan, no federal estate tax is due at the first spouse's passing. At the surviving spouse's death, a maximum of $600,000 passes to noncharitable beneficiaries free of estate tax as the result of the surviving spouse's unified credit.

Under a combination credit shelter/ marital deduction plan, at the first spouse's death a credit shelter share is established to pass property to either nonspousal, noncharitable beneficiaries or to a trust in which the surviving spouse is a beneficiary (and may even be a trustee if the trust is properly drafted), but which is not includable in the surviving spouse's gross estate for federal estate tax purposes. The credit shelter share produces three benefits: 1) it passes free of federal estate tax because of the unified credit (the marital deduction is not applicable to the credit shelter share because the property does not "pass" to the surviving spouse); 2) at the surviving spouse's death, the then value of the credit shelter share passes to the designated beneficiaries free of estate tax (the credit shelter share is not includable in the surviving spouse's gross estate for federal estate tax purposes); and 3) the surviving spouse is able to pass additional property free of estate tax to the extent of the surviving spouse's unified credit. Thus, at the surviving spouse's death a maximum of $1,200,000 (plus appreciation and income earned on the credit shelter share created at the first spouse's death) passes to the beneficiaries free of estate tax.

[14] Other variables include adjusted taxable gifts, other property included in the gross estate passing to beneficiaries which does not qualify for the unlimited marital or charitable deductions, and expenditures which are not taken or allowed as deductions for federal estate tax purposes.

The following example illustrates how one of these variables, prior adjusted taxable gifts, might impact the credit shelter share. Assume the following facts: 1) The decedent has a gross estate of $2,000,000, administration expenses of $100,000, and made lifetime taxable gifts of $300,000; 2) under the terms of the decedent's will, $600,000 of the decedent's estate was specifically bequeathed to the credit shelter share and the remainder was given outright to the surviving spouse; and 3) the administration expenses are taken as deductions on the federal estate tax return and not as income tax deductions.

Based on these facts, the marital deduction equals $1,300,000, which is the $2,000,000 gross estate minus the portion of the gross estate that does not pass to the surviving spouse, $700,000 (the $600,000 credit shelter share plus the $100,000 of administration expenses). Subtracting the allowable deductions of $1,400,000 (the marital deduction of $1,300,000 plus the administration expenses of $100,000) from the gross estate of $2,000,000 produces a taxable estate of $600,000. Adding the taxable estate, $600,000, to the lifetime taxable gifts, $300,000, results in a federal estate tax base of $900,000. The tentative federal estate tax on this amount is $306,800. To arrive at federal estate tax due, this amount is reduced by the amount of total gift taxes "which would have been payable" with respect to lifetime gifts made by the decedent. In this case, the total gift taxes payable are zero (*i.e.*, the transfer tax on $300,000, $87,800, minus $192,800, the unified credit amount, results in a negative number). The unified credit, $192,800, when subtracted from the tentative tax of $306,800, results in a federal estate tax due of $114,000.

The reason that this situation results in a tax due stems from the fact that the credit shelter share should not have been fixed at $600,000. A portion of the unified credit, $87,800, was used to prevent gift tax from being payable on the $300,000 lifetime taxable gifts. Accordingly, the credit shelter share should have been reduced from $600,000 to $300,000. A reduction in the credit shelter share to $300,000 would have correspondingly increased the share qualifying for the marital deduction to $1,600,000. The federal estate tax base then would have

"Ed, we have a problem. We got a lot more done while you were on vacation."

been $600,000 ($300,000 taxable estate plus $300,000 in lifetime taxable gifts). No federal estate tax would have been due because the unified credit would fully offset the tentative tax on this amount $192,800.

[15] The tentative tax on $600,000 equals $155,800, plus 37 percent of the excess of such amount over $500,000, $37,000, or $192,800.

[16] The tentative tax on $642,425 equals $155,800, plus 37 percent of the excess of such amount over $500,000, $52,697, or $208,497.

[17] If the credit shelter share, and, therefore, the taxable estate, were in excess of $642,425, the increase in the federal estate taxes owed, at a marginal 37 percent rate, would not offset the increase in the state death tax credit then available, at a 4.8 percent rate. Thus, if the credit shelter share exceeded $642,425, federal estate tax would be due. Since the formula requires that no federal estate tax be due, the formula prevents the credit shelter share from exceeding $642,425.

[18] Payment of the state death taxes cannot come from the marital share because that would decrease the amount of the marital share qualifying for the marital deduction, thereby resulting in federal estate tax, which would violate the mandate of the formula that no federal estate tax be due.

[19] The $15,697 of state death taxes paid in year one allows an extra $26,728 to pass to the credit shelter share ($42,425 minus the state death taxes owed, $15,697). Even if the $26,728 experiences no appreciation between the first and second spouse's death, this means that a minimum of $26,728 will pass free of estate tax at the surviving spouse's death. If the state death taxes had not been paid, then an extra $42,425 would be included in the surviving spouse's gross estate. The federal estate tax on $42,425 at a marginal tax rate of 37 percent is $15,697, leaving a net to the beneficiaries of $26,728.

[20] If, for example, state death taxes of $15,697 are paid in year one, then an extra $26,728 ($42,425 minus $15,697) passes to the credit shelter share. The credit shelter share, plus appreciation and income thereon, will pass at the surviving spouse's death free of additional federal estate tax. Thus, if the credit shelter share earns 10 percent and the surviving spouse dies at the beginning of the second year following the first spouse's death, an additional $29,401 ($26,728 plus $2,673) pass free of federal estate tax at the death of the surviving spouse. Had there been no state death taxes paid at the first spouse's death, the surviving spouse would have had an extra $42,425 plus $4,242 in his or her estate, or $46,667. At a 55 percent marginal federal estate tax rate, the additional federal estate tax is $25,667, leaving only $21,000—rather than $29,401—to pass to the beneficiaries. Therefore, a tax savings of $8,401 is generated by the payment of state death taxes at the first spouse's death.

[21] FLA. STAT. ANN. §198.13(1) (West 1993).

[22] *Id.* §198.14. A copy of the federal extension request must be filed with the Florida Department of Revenue within 30 days after receipt of the approved federal extension.

[23] *Id.* §198.15(1).

[24] *Id.* §198.15(1). In addition, any tax due on or after July 1, 1991, that is not paid by the due date (including extensions) is subject to a 10 percent penalty if the failure is 30 days or less, or a 20 percent penalty if more than 30 days. *Id.* §198.15(2).

[25] In Technical Advice Memorandum (TAM) 8947005, the IRS determined that the state death tax credit was intended to be effective only as of the date that the state death taxes are paid. Specifically, the IRS held that the state death tax credit may be properly claimed on the federal estate tax return only if the state death taxes have been actually paid by the later of: 1) the filing due date for the federal estate tax return, or 2) the first date prescribed for payment of death taxes under state law, excluding extensions. If state death taxes are paid beyond this time constraint, the state death tax credit will be allowed, but is first effective the date of payment.

[26] The following example illustrates this point. Assume these facts: 1) The taxable estate equals $700,000; 2) The total federal estate tax on a taxable estate of $700,000 equals $229,800 which, after use of the unified credit, results in a tax owed of $37,000; 3) the adjusted taxable estate is $640,000 ($700,000 minus $60,000) which, under the Code §2011(b) table yields a maximum state death tax credit of $18,000; 4) the decedent died in Florida, so that the state death tax equals $18,000; and 5) the Florida Department of Revenue allows for payment of the state death tax in 10 equal installments (pursuant to multiple extension requests).

If the entire state death taxes are paid on or before the last date for filing the federal estate tax return, the total tax burden will equal $37,000. This represents $19,000 in federal estate taxes ($37,000 minus the $18,000 state death tax credit) plus $18,000 in state death taxes.

In contrast, if the estate pays the state death taxes in installments the same amount of total taxes, $37,000, needs to be paid on or before the time prescribed for filing the federal estate tax return. In that event, there is no reduction in the $37,000 owed in federal estate tax until the state death taxes are paid. Although the estate would get a refund of its federal tax paid as state taxes are actually paid in installments, this refund carries with it no interest. *See* I.R.C. §2011(c). In effect, the estate would annually pay $1,800 in state death taxes and receive back $1,800 from the federal estate taxes previously paid. Despite the fact that the overall tax burden remains at $37,000, the estate will be unnecessarily depleted because Florida imposes interest on the unpaid state death tax balance. Although such interest is deductible from the gross estate, Rev. Rul. 81-256, at most 55 percent (37 percent in this example) of the interest paid results in a federal estate tax savings.

[27] If, for example, the estate defers $100,000 in Florida estate tax over a 10-year period, a comparison needs to be made between the rate of return experienced by the $100,000 (or such amount each year which remains after the payment of an installment) during the deferral period versus the federal interest charged as a result of the unpaid state death taxes (*i.e.*, had state death taxes been paid in year one, there would have been a corresponding reduction in federal estate tax liability and, hence, no interest would have been charged on this portion of the reduced federal estate tax liability).

[28] *See, e.g.*, Rev. Rul. 80-250.

[29] *Id.* As a result, a 10 percent interest charge to the estate on the deferred portion of the federal estate tax liability does not cost the estate 10 percent times the amount of the deferred federal estate tax; rather, it costs the estate 10 percent times such deferred tax minus the deferred tax times the highest marginal estate tax rate to which the estate is subject (*i.e.*, the estate tax saved by the deduction generated).

[30] A pragmatic approach is to choose the payment method which facilitates overall estate administration and decreases the costs associated with completing and filing multiple state death tax returns and a federal estate tax return, or filing for or preserving state death tax refunds.

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This column is submitted on behalf of the Real Property, Probate and Trust Law Section, Bruce Marger, chair, and Richard Taylor, Stephen L. Walker, and Thomas E. Allison, editors.

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