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# New Florida Law Could Help Married Couples Realize Major Tax Savings

*The advantages, and potential drawbacks, of The Community Property Trust Act.*

Robert T. Napier , Lorna A. McGeorge | Sep 21, 2022

With little fanfare, Florida is giving married couples who live in the state a gift that could yield over time extraordinary tax savings: the Community Property Trust Act, Fla. Stat. Sections 736.1501-736.1512 (the Act). Signed into law in mid-2021, Florida is one of only five states in the nation offering this innovative tool for estate

planning. Not surprisingly, the Act is stirring keen interest among the wealthy and their financial advisors.

As with any new legislation, Florida's Act could offer some big advantages but there are potential drawbacks too. Let's take a look at exactly what those are and how this estate-planning tool could benefit your clients.

**Advantages**

A community property trust (CPT) is a new way for a married couple to hold assets. (The law allows Floridians and non-Floridians alike to avail themselves of the advantages of CPT. We'll focus here on the possibility of Floridians using a CPT, then later choosing to reside in another state and keep the CPT.) Most significantly, a CPT allows those assets to have a basis adjustment on the death of the first spouse, which could mean substantial savings on capital gains taxes. Consider:

1. CPT assets may have a basis adjustment when first spouse dies. Keep in mind this adjustment could be up or down. This is how marital assets are treated in community-property states of which there are only nine in the United States. (Florida is one of the 41 common-law states.)
2. CPT assets with a low tax basis may receive a step-up to full fair market value (FMV) on the death of the first spouse. This means the surviving spouse could sell those assets and possibly avoid state or federal capital gains taxes. Another potential tax benefit: a CPT may shield assets from the pesky 3.8% net investment income tax.
3. Depreciated assets held in a CPT could bypass the depreciation recapture rules, which could be enormously significant. Depreciation recapture can be very expensive. Even more significant, depreciated assets could then be re-depreciated after the death of the first spouse.
4. If CPT assets are transferred to the surviving spouse after the death of the first spouse, they may be entitled to a second basis adjustment at their death.
5. Assets in a CPT can be removed during a couple's lifetime without the limitations that come with generation-skipping transfer trusts, spousal lifetime access trusts, intentionally defective grantors trusts, grantor retained annuity

trusts or charitable remainder trusts. A CPT functions more like a joint checking account. There are no burdensome rules to follow.

6. CPTs in common-law states have been around since 1998. To date, the Internal Revenue Service hasn't objected to this ingenious tool. There hasn't been a single adverse court or agency ruling against any taxpayer who's established a CPT. Florida is, of course, the most populated and wealthiest of the common-law states to offer this tax-saving tool. Will that prompt the IRS to object? No one knows, but an objection would be awkward for the IRS. After all, the 100 million people who reside in the nine traditional community-property states have enjoyed this benefit for decades.

7. A CPT can hold a Florida couple's primary residence without affecting the homestead exemption and its related benefits. (Fla. Stat. Section 736.151.)

8. A CPT can be structured to leave all assets to the surviving spouse – allowing the assets to be distributed according to their estate plan. Or a CPT can be drafted so its assets would be distributed according to the estate plan of the first spouse to die.

9. Creating a CPT isn't inexpensive, but the potential tax and planning advantages far outweigh the cost.

10. Assets can be removed from a CPT if their FMV falls below the tax basis. CPTs should be actively monitored by a couple's financial advisor.

11. Both spouses can retain control of assets as trustees of the CPT, or one spouse can choose to be the sole trustee.

12. A CPT can hold an interest in a limited liability company (LLC) that owns real estate in Florida – or any other state. This is particularly important because of the potential benefits, specific to real estate, related to depreciation and re-capture.

13. While a couple must be residents of Florida to create a CPT, they can move out of state afterwards and still reap its tax-saving rewards. If they do move, they're required to appoint a Floridian as a trustee to preserve the benefits of their CPT. (Fla. Stat. Section 736.1503(2); Fla. Stat. Section 736.1502(6).

14. A CPT can be revocable or irrevocable. Only the surviving spouse can be named as a qualified beneficiary. This means spouses essentially can guarantee their estate planning desires will be executed.

15. Using a CPT may create a premium over the pro-rata value of assets in the CPT. (*See* Estate of Jackson v. Commissioner, 21 T.C.M. (CCH) 1320 (T.C. 2021)).

**Disadvantages**

1. The IRS hasn't stated expressly whether it will respect the new CPT law in Florida, which differs in some respects to the original opt-in CPT law of Alaska. Some experts worry those differences may make the Florida law more vulnerable to challenge by the IRS. However, the IRS and the Internal Revenue Code allow the advantageous tax basis adjustment rules in the nation's nine community-property states. While there's no guarantee the IRS will respect a Florida CPT, opposing it would be difficult from a legal perspective.
2. Divorce could pose problems for a couple with a CPT. In the event of a split, CPT assets could be divided equally between spouses, even though one may have contributed more. Individuals in an unstable marriage should consider this carefully. Also, a CPT may be problematic if one spouse has substantial non-marital assets. Holding those assets in a CPT could convert them to marital property. One more important caveat: an action by either spouse to dissolve the marriage that remains pending for 180 days – even without a formal dissolution of the marriage – will terminate the CPT unless certain conditions are met. (Fla. Stat. Section 736.1508(2)).
3. A CPT may not be a good tactic for those who've had previous marriages. A CPT could complicate estate planning for spouses who've been widowed or divorced and want to leave assets to children from a previous marriage. Assets in a CPT might be considered comingled and, thus, marital assets.
4. A CPT isn't recommended for those who have significant debt or outstanding personal loan guarantees. Why? Assets within a CPT aren't fully protected from creditor risk. For instance, half the assets could be used to satisfy the creditors of a spouse who has debts.
5. A CPT is unnecessary if a couple doesn't have appreciated assets with which to fund it. On the other hand, a CPT can be a very valuable tool if the couple has assets with substantial unrealized gains.
6. A CPT may be somewhat costly to create. Still, it's inexpensive to operate because there are no burdensome tax filings or governmental reporting requirements.
7. Funding a CPT does require some administrative work such as preparing deeds to transfer property, assigning LLC interests and creating new brokerage accounts. This is usually a minor hassle, though.

8. A CPT requires a trustee must be a resident of Florida. A couple who moves out of state may appoint another resident to be a trustee or hire a professional to act as trustee such as a lawyer or a CPA.

9. The basis adjustments at death could be eliminated by federal law. In the early years of the Biden administration, this was discussed but ultimately dropped. Still, the possibility remains a threat.

10. The IRC has rules designed to avoid the manipulation of tax basis. These provisions, in certain circumstances, can eliminate the basis adjustment of assets gifted to a spouse who fails to live one year beyond the date of transfer. (IRC Section 1014(e)).

11. A CPT could cause the creation of discounts of assets. While discounts may be desirable in a taxable estate, discounts may be undesirable—and even unavoidable—in a non-taxable estate where all assets pass to a surviving spouse.

12. If one or both spouses isn't a U.S. citizen, funding a CPT will create an immediate gift tax liability. Therefore, a CPT typically shouldn't be used by individuals who aren't U.S. citizens.

### Thoughtful Analysis Required

Florida's CPT law is so new some lawyers and accountants are hesitant to employ this new tool for their clients. Their timidity is understandable, but risky. What kind of defense would they offer a widow or widower or their children who might ask why wasn't it proposed or considered? The benefits of a CPT are so compelling that it deserves a thoughtful analysis of the pros and cons.

In our view, that's a discussion well worth having.

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