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FLORIDA'S HOMESTEAD LAWS: PITFALLS AND TRAPS FOR THE NON-FLORIDA PRACTITIONER

*By David Pratt and Barry A. Nelson**

Florida continues to be one of the most popular states for clients to own a second residence and, ultimately, to permanently reside. Indeed, Florida's population increased by approximately 339,000 people between July 1, 2001 and July 1, 2002.1 While Florida's homestead laws would not apply to an individual who is not a Florida resident, once such individual becomes a Florida resident, such laws would apply. Typically, an individual who purchases a vacation home in Florida will take title to the home in a revocable trust or an entity in order to avoid probate of the property upon the individual's death. However, when the individual decides to become a Florida resident, he or she will usually want to treat the home as his or her homestead in order to avail himself or herself of Florida's favorable laws with respect to homestead property.

The purpose of this article is to discuss some of the nuances that apply to Florida's homestead laws so that the non-Florida practitioner who represents a client who purchases a home in Florida can address these issues which will probably apply when the individual decides to become a Florida resident and treats such home as his or her homestead. There are three distinct areas to address: (1) homestead for descent and distribution purposes;[2] (2) homestead for property tax purposes;[3] and (3) homestead for asset protection purposes.[4]

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[1] According to the U.S. Census Bureau, Florida's population between July 1, 2001 and July 1, 2002 increased by approximately 339,819 people.

[2] For an in depth analysis of the descent and distribution laws pertaining to homestead, *see* Rohan Kelley, *Homestead Made Easy*, 65 Fla. Bar J. 3 (March 1991); Rohan Kelley, *Homestead Made Easy, Part II*, 65 Fla. Bar J. 4 (April 1991).

[3] For an in depth discussion regarding the "Save the Homes" cap which pertains to Florida's property tax, *see* Richard Franklin's outline entitled "Protecting & Preserving the Save Our Homes Cap," which was presented at the Florida Bar Real Property, Probate and Trust Law Section Seminar on May 23, 2003 in St. Petersburg, Florida.

[4] For an in depth discussion regarding asset protection issues of Homestead, *see* Barry A. Nelson and Kevin E. Packman, *Florida's Unlimited Homestead Exemption Does Have Some Limits, Part I*, 77 Fla. Bar J. 1 (January 2003); Barry A. Nelson and Kevin E. Packman, *Florida's Unlimited Homestead Exemption Does Have Some Limits, Part II*, 77 Fla. Bar J. 2 (February 2003).

In order for the home to qualify as an individual's homestead, such individual must take affirmative steps to qualify the home as such. Specifically, the individual must have legal or beneficial title in equity to real property on January 1st, reside on such property and in good faith make the same his or her permanent residence, or the permanent residence of another or others legally or naturally dependent upon such person.[5] In order to qualify the home as the homestead property, an individual must apply for such exemption, in person, at the property appraiser's office, between January 1st and March 1st of the year for which the exemption is sought.

In addition to qualifying the home as homestead, the individual who wants to perfect his or her Florida domicile should take affirmative steps to become a Florida domiciliary, (i.e., obtaining a Florida driver's license, registering to vote in Florida, etc.[6]), including the filing of a "declaration of domicile" in the county in which he or she resides.[7] A sample of such a declaration is provided at the end of this article.

During a homestead owner's lifetime, he or she may alienate the homestead by mortgage, sale or gift, but only if the homestead owner's spouse joins the alienation. In addition, if married, the homestead owner may by deed transfer the title to an estate by the entirety with his or her spouse.[8]

DESCENT AND DISTRIBUTION

The Florida Constitution and Florida Statutes address how a homestead may be distributed upon the owner's death and the consequences of an invalid devise of the homestead. Section 4(c) of Article X of the Florida Constitution states, in relevant part, that the:

> Homestead shall not be subject to devise if the owner is survived by spouse or minor child, except the homestead may be devised to the owner's spouse if there be no minor child. The owner of homestead real estate, joined by the spouse if married, may alienate the homestead by mortgage, sale or gift and, if married, may by deed transfer the title to an estate by the entirety.[9]

Section 732.401(1) of the Florida Statutes further provides that "[i]f not devised as permitted by law and the Florida Constitution, the homestead shall descend in the same manner as other intestate property; but if the decedent is survived by a spouse and lineal descendants, the surviving spouse shall take a life estate in the homestead, with a vested remainder to the lineal descendants in being at the time of the decedent's death."[10] Moreover, "the homestead shall not be subject to devise if the owner is survived by a spouse or a minor child, except that the homestead may be devised to the owner's spouse if there is no minor child."[11] These rules also apply to a homestead owned by a

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[5] *See* F.S. 196.031(1).

[6] A full discussion of the steps to take to become a Florida resident is beyond the scope of this article.

[7] *See* F.S. § 222.17.

[8] Section 4(c) of Article X of the Florida Constitution.

[9] *Id.*

[10] F.S § 732.401.

[11] F.S. § 732.4015(1).

revocable trust and the term "devise" includes a "disposition by trust of that portion of the trust estate which, if titled in the name of the settlor of the trust would be the settlor's homestead."[12]

While these laws regarding homestead may appear to be straightforward, in practice, it is not uncommon for the homestead to be improperly devised. Furthermore, when second marriages and stepchildren enter the equation, or planning is undertaken to fund a credit shelter or marital trust with all or a partial interest in the homestead upon the first dying spouse's demise, the results may be in direct conflict with the testator's intentions.

As set forth in the Florida Constitution and Statutes, if an individual is not survived by a spouse or a minor child, the individual may devise the homestead in any manner he or she wishes. However, if the individual has no minor children, but does have a spouse, then the only permitted devisee of the homestead is the spouse. For these purposes, a devise would include a specific devise of the homestead or the homestead's passing as part of the residue of an estate or revocable trust.

If the homestead is improperly devised (or not devised at all) and the decedent is survived by a spouse and lineal descendants, the spouse receives a life estate in the property and the descendants receive the remainder interest. For these purposes, "stepdescendants" would not be included within the definition of descendants. If the decedent is not survived by a spouse or lineal descendants, then the property passes pursuant to the laws of intestacy (assuming the decedent died intestate).[13]

When planning to use the estate tax exemption of the first spouse to die, the practitioner will usually recommend that each spouse have a sufficient amount of assets in his and her names (or revocable trusts) in order to fund a credit shelter or QTIP trust (and making a partial QTIP election or no election at all) upon the death of the first dying spouse. Accordingly, in dividing the couple's assets, it is not uncommon to transfer title to the homestead to one of the spouses or to both of the spouses as tenants in common.[14] While such a transfer may be prudent from a Federal transfer tax perspective, it will be necessary for the spouse to waive his or her homestead rights with respect to descent and distribution during his or her life. Otherwise, upon the death of the spouse who owned the home (or an undivided partial interest therein), assuming he or she was the first dying spouse, the devise would be invalid. In such a case, the surviving spouse would receive a life estate and the deceased spouse's descendants would receive a remainder interest in the property. While it may be possible to make a partial QTIP election (or no election at all) for the surviving spouse's life estate in order to utilize the estate tax exemption of the first dying spouse, the home will be distributed to such spouse's descendants, outright and free of trust, upon the surviving spouse's demise. Such a disposition may be different than the dispositive provisions that would have otherwise applied if the home would have been distributed to the credit shelter or marital trust, as contemplated. For example, step-descendants or others may have been the remainder beneficiaries of such a trust.

As mentioned above, a homestead waiver will need to be executed if the individual wants the home

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[12] F.S. § 732.4015(2).

[13] *See* F.S. § 732.401.

[14] It should be noted that the transfer of the home to one of the spouses could trigger the imposition of Florida documentary stamp tax if the real estate is encumbered. In general, the consideration is the balance of the mortgage at the time of the transfer and the tax is imposed on one-half of the balance at a rate of $7 per $1,000. F.S. § 201.02(1).

to be distributed pursuant to the terms of the credit shelter or marital trust. A sample homestead waiver is provided at the end of this article.

Regarding the waiver, such a document could be construed as a post-nuptial agreement between the spouses. Under Florida law, the rights of a surviving spouse to homestead (or elective share, intestate share, pretermitted share, exempt property, family allowance and preference in appointment as personal representative of an intestate estate) may be waived, wholly or partly, before or after the marriage, by written contract, agreement or waiver, signed by the waiving party in the presence of two subscribing witnesses.[15] Furthermore, in most well drafted post-nuptial agreements, both spouses are represented by independent counsel. From a practical perspective, when clients are executing homestead waivers, however, they are not being represented by independent counsel and are not including full disclosure of their assets. It is uncertain whether the failure to include full disclosure of assets and separate legal representation would invalidate the homestead waiver.

PROPERTY TAX ISSUES

A Florida resident who owns homestead property is entitled to two tax breaks with respect to the assessment of real property taxes on his or her homestead. The first break is nominal, but the second one can be significant. Again, in order to benefit from these rules, the individual must take the affirmative steps necessary to qualify the home as the homestead, as discussed above.

The first benefit relates to the $25,000 reduction on the assessed valuation of the homestead property. All real property owned in Florida is subject to real property tax based on the millage rate applicable to the county in which the real property is located multiplied by the assessed valuation.[16] The assessed valuation is reduced by $25,000 if the property is homestead property.[17] Such reduction generally translates into a tax savings of a few hundred dollars.

The second benefit relates to the limitation imposed on the annual valuation of homestead property for property tax purposes and is commonly known as the "Save the Homes" cap. Such limitation provides that the annual increase in an assessment of real property which qualifies as homestead property may not exceed the lesser of three percent (3%) or the percent change in the Consumer Price Index from the prior year.[18]

In some areas in Florida, the differences between the assessed valuations of neighboring properties can be staggering. For example, consider the individual who has resided on his beachfront property for the past twenty-five years and compare him to his new neighbor who just purchased a similar home. The practitioner must be cognizant of the "Save The Homes" cap in order to ensure that it is maintained for as long as possible.

In general, a transfer of the real property will trigger a revaluation of the homestead for real property tax purposes. There are a few exceptions to this rule; the most relevant exceptions, for purposes of

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[15] F.S. § 732.702.

[16] *See* Section 2 of Article VII of the Florida Constitution.

[17] *See* Section 6 of Article VII of the Florida Constitution; F.S. 196.031.

[18] *See* Section 4(c) of Article VII of the Florida Constitution; F.S. 193.155.

this article, are for transfers (1) between a husband and wife; (2) which occur by operation of the homestead laws, as discussed above (i.e., life estate in spouse and vested remainder in lineal descendants); and (3) upon death to a dependent person.

There are two common situations in which the "Save the Homes" cap should be addressed. First, when a homestead passes to a trust of which the surviving spouse is a beneficiary (i.e., a credit shelter or QTIP trust), the "Save The Homes" cap should apply, provided that the surviving spouse has an "equitable interest for life" in the homestead property. Accordingly, language such as the following should be included in any such trust:

> Notwithstanding anything to the contrary contained herein, if any portion of the real property which qualified as my homestead during my life is an asset of any trust established upon my death of which my spouse is a beneficiary, my spouse shall have the exclusive and continuous present right to full use, occupancy and possession of such homestead residence for life. It is my intention that my spouse's interest in such property shall constitute a "beneficial interest for life" and equitable title to real estate" as contemplated by Florida Statutes Section 196.041(2) and this instrument shall be construed accordingly.

Second, when a home is transferred to a qualified personal residence trust,[19] the home should maintain its homestead status during the term of the trust.[20] However, the limitation may no longer apply at the expiration of the term (i.e., if the home is distributed to the children at that time). Thus, practitioners should alert their clients to the potential loss of the limitation prior to their execution of the qualified personal residence trust.

It is important to note that the transfer of the home to a revocable trust should not affect the homestead status for property tax purposes. However, when a home is conveyed to a revocable trust, the property owner should advise the property tax appraiser's office that the property owner has the necessary beneficial interest in the trust in order to maintain homestead status. Typically, the property tax appraiser's office will send a "certificate of trust" to the owner after a deed is recorded which conveys a home to the revocable trust. The owner should complete such certificate and return it to the property tax appraiser's office promptly. In addition, language should be included in a revocable trust (and a qualified personal residence trust) to ensure that the home will maintain its homestead status. An example of such language is as follows:

> Grantor reserves the right to reside upon any real property placed in this Trust as Grantor's permanent residence during Grantor's life, it being the intent of this provision to retain for Grantor the requisite beneficial interest and possessory right in and to such real property to comply with Section 196.041 of the Florida Statutes, such that said beneficial interest and possessory right constitute, in all respects, "equitable title to real estate" as that term is used in Section 6, Article VII of the Constitution of the State of Florida.

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[19] *See* IRC § 2702 (2003).

[20] *See Robbins v. Wellbaum*, 664 So.2d 1(Fla. 3d CDA 1995). However, in order to ensure that the homestead exemption will be preserved during the term of the trust, practitioners should request a written opinion from the local property tax appraiser's office where the real property is located.

ASSET PROTECTION

Many Floridians enjoy the security of knowing that Florida's liberal "unlimited" homestead exemption protects their family residence from creditors. However, there are numerous limitations and traps to avoid to be certain to obtain protection from the homestead exemption. Accordingly, there are serious dangers for those who believe that all it takes to gain the protection of the exemption is to move to Florida and purchase or construct an expensive home.

National newspapers have generated a misunderstanding amongst their readers regarding the ease with which the homestead exemption may be obtained by stating that those involved in litigation or those who have procured funds fraudulently can simply build an expensive home that would gain homestead protection. For example, on July 12, 2002 The Washington Post[21] reported that Scott D. Sullivan, former CFO of WorldCom, is building a $15 million Boca Raton "mansion" that may qualify for homestead exemption status. Unfortunately these articles do not explain the limitations on Florida's homestead exemption. Based upon the number of recent cases interpreting Florida's homestead exemption, it is an issue of practical application.

FLORIDA CONSTITUTION

The starting point for understanding Florida's homestead exemption for asset protection is Article X, Section 4(a) of the Florida Constitution, which states, in relevant part:

> There shall be exempt from forced sale under process of any court, and no judgment, decree or execution shall be a lien thereon, except for the payment of taxes and assessments thereon, obligations contracted for the purchase, improvement or repair thereof, or obligations contracted for house, field or other labor performed on the realty, the following property owned by a natural person: (1) a homestead, if located outside a municipality, to the extent of one hundred sixty acres of contiguous land and improvements thereon, which shall not be reduced without the owner's consent by reason of subsequent inclusion in a municipality; or if located within a municipality, to the extent of one-half acre of contiguous land, upon which the exemption shall be limited to the residence of the owner or the owner's family. . . .

Thus, there are three significant requirements that the courts must consider in order to determine whether a debtor's homestead qualifies for Florida's constitutional exemption from forced sale: (1) acreage limitations; (2) residency requirements; and (3) ownership requirements. Of course, to be eligible for protection from creditors, the property must be located in the State of Florida.[22] An additional factor is whether the funds used to obtain the homestead were fraudulently obtained.[23]

THE POLICY BEHIND THE HOMESTEAD EXEMPTION

Because the purpose of the unlimited exemption is to protect families from misfortune, the burden is

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[21] Jackie Spinner, The Washington Post, "*Homes Remain Rogue Executives' Castles Under Loophole*."

[22] *In re Sanders*, 72 B.R. 124, 125 (Bankr. M.D.Fla. 1987).

[23] *In re Financial Federated Title and Trust, Inc.*, 2003 U.S. App. LEXIS 20229 (11th Cir. 2003), *aff'g*, 273 B.R. 706 (Bankr. S.D.Fla. 2001).

on the creditor to argue against homestead protection.[24] In *Public Health Trust v. Lopez*,[25] the court stated that the purpose of the homestead law is to promote the stability and welfare of the state by securing to the householder a home, so that the homeowner may live beyond the reach of financial misfortune. Similarly, in *Orange Brevard Plumbing & Heating Co. v. La Croix*,[26] the court said that the purpose of the homestead law "is to benefit the debtor by securing his or her homestead beyond all liability from forced sale under process of any court." Such cases reflect the liberalness in which courts will interpret the homestead exemption so that families will have shelter and not be reduced to absolute destitution.

ACREAGE LIMITATIONS ON HOMESTEAD

Whether the residence is within or without a municipality is of critical importance in determining the portion of the debtor's homestead that will be protected. As stated above, Florida's constitutional protection is generally limited to the extent of one-half acre if the residence is located within a municipality. Until 1997, when the United States Supreme Court denied Certiori in *In re Englander*,[27] thereby letting stand the decision of the 11th Circuit Court of Appeals,[28] the extent to which homestead protection was available for a residence on more than one-half acre within a municipality was uncertain.[29] The debtor in *Englande*r owned a home on approximately one acre within a municipality, and the property could not be legally subdivided due to local zoning regulations. The debtor claimed a homestead exemption for a portion of the property that surrounded the non-exempt portion, eliminating any reasonable access to the non-exempt portion and rendering it valueless. The court, in reaching its conclusion that the homestead designation sought for a portion of the property was improper, stated that the debtor's "attempt at homestead exemption 'gerrymandering' was clearly in bad faith.[30] The Bankruptcy Court granted the debtor an exemption in a portion of the proceeds to be derived from the sale of the property equal to the value of one half

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[24] *Lewton v. Hower,* 18 Fla. 872, 882 (Fla. 1882); *Graham v. Azar,* 204 So. 2d 193, 195 (Fla. 1967); *In re Haning,* 252 B.R. 799, 806 (Bankr. M.D. Fla. 2000), citing *In re Ehnle,* 124 B.R. 361, 363 (Bankr. M.D. Fla. 1991) ("placing the burden on objecting party to establish with preponderance of evidence that debtors are not entitled to claimed exemption").

[25] 531 So. 2d 946, 948 (Fla. 1988), *aff'g*. 509 So. 2d 1286 (Fla. 4th D.C.A. 1987).

[26] 137 So. 2d 201, 204 (Fla. 1962).

[27] 520 U.S. 1186.

[28] *Englander v. Mills* (*In re Englander*), 95 F.3d 1028 (11th Cir. 1996). *See also In re Nofsinger*, 221 B.R. 1018 (Bankr. S.D. Fla. 1998), following *Englander*, which provided the parties thirty (30) days from the Order to submit an agreed order as to the value of the property that was not protected by homestead and the manner in which said amount was to be paid to the Bankruptcy Trustee for inclusion in the debtor's bankruptcy estate. Otherwise, the Trustee was authorized to sell the homestead (as set forth in *Englander*) and "the Court will apportion the proceeds accordingly." *Id.* at 1021.

[29] Several Florida bankruptcy courts found that when the homestead property is not divisible, the trustee could sell the property and the court would apportion the proceeds. *In re Wierschem,* 152 B.R. 345, 347 (Bankr. M.D.Fla. 1993); *In re Baxt,* 188 B.R. 322, 323-324 (Bankr. S.D.Fla. 1995). Reflecting a contrary view, a court found that when the homestead was divisible, but the zoning laws prevented a sale, that the entire property would be exempt homestead. *In re Kuver,* 70 B.R. 192 (Bankr. S.D.Fla. 1986). Similarly, the Florida Supreme Court ordered the division and sale of property when a portion of the property was not being used as homestead. *Smith v. Guckenheimer,* 42 Fla. 1, 19 (Fla. 1900).

[30] *In re Englander,* 156 B.R. 862, 864 (Bankr. M.D. Fla. 1992).

acre.[31] The court reasoned that a sale and apportionment of the sales proceeds is an equitable solution that allows for the appropriate recognition of the debtor's homestead and affords creditors some satisfaction of their claims.

When given the opportunity, in *In re Kellogg,*[32] the 11th Circuit Court of Appeals reinforced *Englander*. In *Kellogg*, the debtor, who owned a 1.3 acre oceanfront home in Palm Beach, argued his home should not be sold to pay creditors. Instead, the debtor reasoned, he should be able to remain in his residence and surrounding property to the extent of one-half acre with the remaining acreage assigned to creditors. Relying on *Englander*, the court ordered the sale of the homestead property. The proceeds were allocated with the portion of the proceeds which exceeded those attributable to one-half acre being made available to creditors.

The *Englander* approach was also followed in *In re Quraeshi,*[33] where the debtor claimed the homestead exemption on his residence which was situated on 2.69 acres located within a municipality. The Trustee objected to the debtor's claim of exemption when the debtor sought permission to sell the homestead. The Trustee argued that the Florida Constitution, Art. X, Section 4 states that a homestead cannot exceed one-half acre in a municipality. The parties agreed that the residence was indivisible. The court sustained the Trustee's objection and found that the debtor's exempt one-half acre would equate to 19% of the total acreage and, thus, the debtor was entitled to 19% of the proceeds. The home was sold for $760,000 and, after satisfying the mortgages (first and second) and closing costs, $216,000 remained. The debtor filed an appeal challenging the method in which the bankruptcy court calculated the 19%. The debtor alleged he was entitled to 19% of the gross sales price of $760,000, rather than 19% of the net sale price of $216,000 (i.e., the gross sales price less mortgages, tax liens and the like). *Quraeshi* was the first reported Florida case addressing how assets should be apportioned when the acreage exceeds one-half an acre within a municipality and the property cannot be partitioned. In order for the property to be partitioned, there would have to be an exempt one-half acre (on which the debtor would presumably continue to reside) and a remaining non-exempt portion (for which there would be a valid use).

The *Quraeshi* Court recognized that there was no case law in Florida or in the Eleventh Circuit on point; thus, it would have to examine the plain language of the Florida Constitution. The court found that the homestead provision "specifically excludes a small number of debts - mortgages, real property taxes, repairs to improve the land - that are connected to the real property . . . . Based on the language of the homestead provision, it would seem that a debtor's homestead exemption would extend to a pro rata portion of the net proceeds of a sale of a debtor's property, based on his acreage share of the property sold, rather than on a pro rata portion of the gross sales price."[34] Consequently, the Court determined that the gross sales proceeds had to be used to satisfy the excluded liens before any portion of the proceeds could be considered the debtor's homestead.

As shown by the *Englander*, *Kellogg* and *Quraeshi* decisions, courts can order the sale of a homestead when such property (i) exceeds the constitutional size limitations set forth in the Florida

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[31] *Id*. at 870.

[32] 197 F. 3d 1116 (1999).

[33] 289 B.R. 240 (Bankr. S.D. Fla. 2002).

[34] *Id*. at 244.

constitution, and (ii) the property cannot be practically or legally subdivided. Consequently, it may be advisable for individuals concerned about retaining protection for all of their homestead real estate to either purchase a residence outside a municipality on 160 acres or less or to purchase a residence within a municipality located on no more than one-half of an acre. Alternatively, a would-be debtor could purchase a condominium, which could be fully protected by the exemption.

As noted above, Article X, Section 4(a)(1) of Florida's Constitution provides the acreage limitation may not be reduced without the owner's consent by reason of subsequent inclusion in a municipality. Thus, assuming the size of the homestead does not exceed 160 acres, homeowners need not be concerned whether they will lose their homestead protection if they live in a home that exceeds one-half acre within an unincorporated area that later becomes a municipality. Many Florida municipalities have incorporated since 1990. Persons owning homes in new municipalities on more than one-half of an acre (but on no more than 160 acres) before the date of the municipal incorporation will continue to benefit from the 160-acre limitation for as long as their homes continue as their homestead. Accordingly, certain homes within new municipalities are effectively "grandfathered" for homestead protection while those purchased after becoming a municipality are subject to the usual one-half acre limitation. This distinction causes a potential trap for those advisors who simply apply the one-half acre rule without questioning the date of incorporation of a municipality and the date that home was purchased. Furthermore, the rules set malpractice traps for advisors unfamiliar with the law who may advise a "grandfathered" homeowner to convey the homestead to a limited partnership because once the conveyance is made, the protection will be lost.

As discussed below, it is not clear whether a homestead owned by a revocable trust maintains homestead protection or whether such a conveyance could result in loss of the "grandfathered" exempt status. Therefore, before a protected homestead is conveyed into any estate planning entity, one needs to be assured that the conveyance will not result in a loss of asset protection benefits. Accordingly, the safest approach, notwithstanding the estate tax or probate avoidance benefits of other forms of ownership, such as revocable trusts or QPRTs, may be to leave title of a protected homestead as is (i.e., in individual name).

RESIDENCE LIMITATIONS FOR HOMESTEAD

To obtain the benefits of the homestead exemption for asset protection the debtor must be a resident in Florida. In order to be a resident of Florida, the debtor must have a residence in the state as well as the actual intent to permanently reside in Florida.[35]

An alien debtor can only satisfy the permanent residency requirement if the debtor is granted a permanent visa or "green card."[36] The Bankruptcy Court, in *In re Bermudez,*[37] and *In re Cooke,*[38] reasoned "unless the debtor is issued such permanent status, the alien debtor cannot legally

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[35] *Hillsborough Inv. Co. v. Wilcox,* 13 So. 2d 448, 452 (Fla. 1943); *In re Cooke,* 412 So. 2d 340, 342 (Fla. 1982).

[36] *In re Bermudez,* 1992 Bankr. LEXIS 547, at *4 (Bankr. S.D. Fla. 1992); *Raheb v. DiBattisto,* 513 So. 2d 717 (Fla. 3d D.C.A. 987).

[37] 1992 Bankr. LEXIS 547, at * 4 (Bankr. S.D. Fla. 1992), *citing In re Gilman, 68 Bankr. 374, 375-376 (Bankr. S.D. Fla. 1986).*

[38] 412 So. 2d 340, 342 (Fla. 1982).

formulate the requisite intent to make the house the family's permanent residence, regardless of the debtor's subjective intention to remain indefinitely." Accordingly, in *In re Boone*,[39] the Bankruptcy Court held that a non-citizen of the United States, who had failed to maintain her U.S. visa status and had lost the right to remain in the United States at the time she filed for bankruptcy, was not a resident of Florida for purposes of the exemption from forced sale of homestead.

OWNERSHIP REQUIREMENTS FOR HOMESTEAD

Once debtors have established a Florida residence on the requisite acreage, in order to obtain protection, they must also meet ownership requirements. The identity of the legal owner of the homestead can have dramatic impact on the availability of the exemption. In *Crews v. Bononetto (In re Bosonetto),*[40] the Bankruptcy Court, in a controversial decision, held that a debtor could not claim the homestead exemption from forced sale for a personal residence she owned not in her individual capacity, but as trustee of the revocable trust into which she had conveyed the homestead. The court reasoned that the homestead exemption from forced sale can only be claimed for property owned by a natural person.[41] *Bosonetto* was neither followed nor mentioned in *Callava v. Feinberg,*[42] where the court stated that an individual claiming homestead exemption need not hold fee simple title to the property. In *Callava,* title to property was held in the name of a trustee. Notwithstanding the debtor's victory in *Callava*, if homestead protection for asset protection purposes is an objective, the most conservative approach until this issue has been more clearly resolved is to hold title in an individual capacity or as tenants by the entirety for husband and wife, and not through a trust, corporation, partnership, LLC, or other entity.

KINDS OF RESIDENCE QUALIFYING AS HOMESTEAD

The types of residence that have been found to qualify as homestead are countless. Moreover, the interest in the underlying homestead can be fractional,[43] a leasehold,[44] or a share in a co-operative apartment.[45] In *Southern Walls, Inc. v. Stilwell Corp.*, the court stated, "[a]lthough a castle to one person may be a shanty to another, the law does not so discriminate. Thus, regardless of whether one's castle is a traditional family home or a modest cottage, whether it is a rural farmhouse or a villa by the sea, whether it floats or sits on wheels, whether it is a condominium or a co-op, it should receive the same protection under Florida law."[46]

Courts and legislation have extended the protection of homestead from forced sale to include many locations beyond the typical home. Chapter 222 of the Florida Statutes is the legislature's

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[39] 134 B.R. 979 (Bankr. M.D. Fla. 1991).

[40] 271 B.R. 403 (Bankr. M.D. Fla. 2001).

[41] *Id.* at 406.

[42] 2003 Fla. App. LEXIS 15467 (Fla. 3d D.C.A. 2003).

[43] *Vandiver v. Vincent,* 139 So. 2d 704 (Fla. 2d D.C.A. 1962).

[44] *In re McAtee*, 154 B.R. 346, 349 (Bankr. N.D. Fla. 1993) (holding that a 99-year lease was an ownership interest that satisfied the requirements of Florida's homestead exemption to forced sale).

[45] *In re Dean*, 177 B.R. 727 (Bankr. S.D. Fla. 1995).

[46] *S. Walls, Inc. v. Stilwell Corp.*, 810 So. 2d 566, 571 (Fla. 5th D.C.A. 2002).

implementation of Florida's constitutional protection against the forced sale of homestead. Section 222.05 provides: "[a]ny person owning and occupying any dwelling house, including a mobile home used as a residence, or modular home, on land not his or her own which he or she may lawfully possess, by lease or otherwise, and claiming such house, mobile home, or modular home as his or her homestead, shall be entitled to the exemption of such house, mobile home, or modular home from levy and sale as aforesaid."[47]

For an additional discussion on the types of properties that have qualified for homestead protections, *see* Nelson and Packman, *Florida's Unlimited Homestead Exemption Does Have Some Limits - Part 1*, 77 FLA. B.J. 60 (Jan. 2003).

OCCUPANCY IS GENERALLY A PREREQUISITE TO HOMESTEAD STATUS

Despite contrary statements in recent newspaper articles,[48] a majority of Florida courts have ruled that neither a home under construction nor a vacant lot is eligible for the homestead exemption from forced sale. This issue appears to have been settled in the 1882 case of *Drucker v. Rothstein*,[49] where the court held that a parcel of land, never occupied as a dwelling place or home, and incapable of such occupancy, is not a homestead under the Florida Constitution. The *Drucker* opinion stated "[a] bare lot unoccupied cannot be a homestead. Lumber placed upon it for the purpose of building is not such occupancy, even though there may be a contract made for building."[50] Similarly, in *In Re Estate of Ritter*,[51] a vacant lot owned by the debtor and adjoining his homestead was found not to be part of the debtor's homestead residence. The court, in *In Re. Estate of Ritter*, reasoned that "[the lot] at no time had any structures or improvements built upon it which served the residence . . . and was never jointly fenced in with the [residence]. It was merely a separate, empty lot which served, at best, as an excess side yard to the aforementioned residence."[52] For an additional discussion on the types of properties that have qualified for homestead protections, *see* Nelson and Packman, *Florida's Unlimited Homestead Exemption Does Have Some Limits - Part 1*. 77 FLA. B.J. 60 (Jan. 2003).

LIMITATIONS ON FLORIDA'S HOMESTEAD EXEMPTION IMPOSED BY FEDERAL TAX LAW

In some cases Federal tax law will pre-empt Florida's homestead exemption for asset protection purposes. In 1998, the Bankruptcy Court held that a Federal tax lien was held to be enforceable against homestead property.[53] The court found that "the homestead exemption does not erect a

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[47] *See* F.S. § 222.05.

[48] Jon Swartz, *Sullivan Estate Might Not be Exempt*, USA Today, August 13, 2002; Howard Goodman, *As Work Fret*, Ex-CFO's Xanadu Rises, Ft. Lauderdale Sun-Sentinel, July 25, 2002; Jon Swartz, *Homes of the Rich and Today*, July 15, 2002; Philip Shenon, *Law Professors Express Concern Over Pending Bankruptcy Bill*, The New 22, 2002; Craig Gilbert, *Kohn Deal Tightens "Luxury Loophole*," Milwaukee Journal Sentinel, April 24, 2002.

[49] 19 Fla. 191 (1882).

[50] *Id*.

[51] 407 So. 2d 386 (Fla. 3d D.C.A. 1981).

[52] *Id*. at 387.

[53] *In re McFadyen*, 216 B.R. 1006, 1008 (Bankr. M.D. Fla. 1998).

barrier around a taxpayer's home sturdy enough to keep out the Commissioner of the Internal Revenue."[54] However, due to Congress' concern that seizure of a taxpayer's principal residence is particularly disruptive for the taxpayer and the taxpayer's family, a taxpayer's principal residence may only be seized to satisfy a taxpayer's tax liability as a last resort. Further, the taxpayer's residence is otherwise exempt from levy unless a judge or magistrate of a United States district court approves of the levy in writing.[55] Similarly, a Federal court held that a Federal forfeiture statute preempts Florida's homestead exemption.[56] Note, however, that when a judgment is recorded prior to the debtor establishing homestead status, the residence is subject to levy.

CERTAIN QUESTIONABLE AND FRAUDULENT CONVEYANCES MAY STILL BENEFIT FROM HOMESTEAD PROTECTION

Florida court decisions have stated, in dicta, that the homestead exemption should not be used as an instrument of fraud upon creditors.[57] However, when presented with an opportunity to limit the application of the exemption under circumstances smelling of fraud, the Florida Supreme Court refused to do so. In *Havoco of America, Ltd. v. Hill*,[58] judgment was entered against the debtor, a resident of Tennessee, on December 19, 1990. The enforceability of the judgment was delayed until January 2, 1991. With full knowledge of the judgment, the debtor purchased a Florida home on December 30, 1990, using non-exempt funds that would have been available to the known creditor, intentionally converting them into Florida homestead property. The Florida Supreme Court reasoned that when an equitable lien is sought against homestead real property, some fraudulent or otherwise egregious act by the beneficiary of the homestead protection must be proven and that the creditor did not provide such proof.[59] The Court determined that the debtor's conversion of funds to avoid a creditor was not one of the three exceptions to the homestead exemption under the Florida Constitution and as such refused to extend equitable principles.[60] The three exceptions under the Florida Constitution under which a forced sale of a homestead may take place, as cited in *Havoco*, are (1) payment of taxes and assessments thereon; (2) obligations contracted for the purchase, improvement or repair thereon; or (3) obligations contracted for house, field or other labor performed on the property.[61]

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[54] *Id*. at 1009, quoting *Thompson v. Adams*, 685 F. Supp. 842, 846 (M.D. Fla. 1988), *quoting U.S. v. Estes*, 450 F. 2d 62, 65 (5th Cir. 1971).

[55] *See* 26 U.S.C.S. F.S. § 6334(a)(13)(B) and (e) (2003); *see also* the Taxpayer Bill of Rights incorporated in the IRS Restructuring and Reform Act of 1998 effective July 22, 1998.

[56] *United States v. One Single Family Residence Without Buildings, Without Buildings Located at 212 Airport Rd. South, et. al.,* 771 F. Supp. 1214 (S.D. Fla. 1991).

[57] *Simpson v. Simpson*, 123 So. 2d 289, 294 (Fla. 2d D.C.A. 1960); *Frase v. Branch*, 362 So. 2d 317, 319 (Fla. 2d D.C.A. 1978) ("Great care should be taken to prevent homestead laws from becoming instruments of fraud, an imposition on means to escape honest debts."); *Englander*, 95 F. 3d 1028, 1031 ("The homestead exemption law is intended to be a shield, not a sword, and should not be applied as to make it an instrument of fraud or as an imposition upon creditors.").

[58] 790 So. 2d 1018 (Fla. 2001).

[59] *Id*. at 1027.

[60] *Id*. at 1028.

[61] *Id*. at 1022.

A potential danger of situations in which there is egregious conduct, however, is the possibility that the Bankruptcy Court may choose to withhold discharge or dismiss the bankruptcy altogether thereby permitting creditors to survive bankruptcy.[62] However the court in *In re Financial Federated Title & Trust, Inc.*,[63] authorized a Trustee to impose an equitable lien and constructive trust on the proceeds from the sale of a homestead property on the grounds that most if not all of the funds used to purchase the property could be traced directly back to fraud. The *Financial Federated* court extensively cited to *Jones v. Carpenter,*[64] where the Supreme Court of Florida established that the homestead "cannot be employed as a shield and defense after fraudulently imposing on others."[65] The *Jones* court stated: "[A]ppellee in other words takes the position that as resident of the Jacksonville Bread Company . . . he can then fraudulently or surreptitiously extract from its assets the sum of $535.84 in cash and use the same to improve his home thereby contributing to the bankruptcy of the Bread Company to the detriment of innocent creditors and then claim immunity from repaying the funds or assets so taken by virtue of his homestead exemption. Purely from a standpoint of commercial or business ethics it would be difficult to state a set of facts constituting more reprehensible conduct, and while this court has repeatedly held that organic and statutory provisions relating to homestead exemptions should be liberally construed in the interest of the family home, they should not be applied so as to make them an instrument of fraud or imposition upon creditors."[66]

The *Financial Federated* court stated that since the funds used to pay for the residence were fraudentlty obtained, it would decide the case based upon the *Jones* holding, which it claimed remains the law in Florida.[67] The court stated that the imposition of the equitable lien in favor of [the Trustee] is necessary to prevent defendants from using the homestead exemption as an instrument of fraud and to prevent the defendant's unjust enrichment at the expense of the defrauded investors. An equitable lien will allow a means for [the Trustee] to recover at least a portion of the fraudently obtained funds.[68]

Other interesting issues discussed in *Financial Federated* include whether (i) lack of knowledge on the part of the debtor's spouse would protect the homestead, and (ii) an equitable lien could be imposed on the home owned by debtor's son and his wife when they satisfied their mortgage with funds debtor fraudulently obtained. In both instances the opinion stated that an equitable lien should be imposed to prevent unjust enrichment. Accordingly, notwithstanding *Havaco,* if the three

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[62] *Havoco*, 197 F. 3d 1135, 1143 n. 12. ("Adding to the confusion in this area is the conclusion of some courts that, although a debtor's fraudulent conversion of non-exempt assets into a homestead does not provide a basis for denying him the exemption, the debtor's fraudulent transfer may serve as the predicate for denying the discharge. *See, e.g., Marine Midland Bank, N.A. v. Mellon*, 160 B.R. 860 (Bankr. M.D. Fla. 1993) (denying discharge under 11 U.S.C. § 727(a) (2) (A) when the "debtor who clearly by law is entitled to convert nonexempt assets to exempt assets did so in this case with a fraudulent intent."); *In Re Hendricks*, 237 B.R. 821, 826 (Bankr. M.D. Fla. 1999); *In re Young*, 235 B.R. 666, 671 (Bankr. M.D. Fla. 1999).")

[63] 273 B.R. 706 (Bankr. S.D. Fla. 2001, *aff'd.* U.S. App. LEXIS 20229).

[64] 90 Fla. 407 (Fla. 1925).

[65] *Id.* at 417.

[66] *Id*. at 416.

[67] *In re Financial Federated Title & Trust, Inc., infra.*

[68] *Id*. at 719.

homestead requirements are satisfied for (i) acreage; (ii) residence; and (iii) ownership, where funds used to purchase the homestead (or pay down a mortgage on a homestead) are traced to fraudulent activity, whether for a residence owned by the debtor or by others, an equitable lien may be imposed to prevent unjust enrichment.

PROPOSED FEDERAL BANKRUPTCY LEGISLATION

To curb the perceived abuses of the homestead exemption in Florida and other states, Congress has been considering ways to overhaul the nation's bankruptcy laws since 1997. In 2001, separate bankruptcy reform bills were passed by the Senate and House that, if enacted, could have an enormous impact on the value of a homestead that may escape a bankruptcy. There was much debate and conflict between the House and Senate versions, with one key area of dispute being the unlimited homestead exemption permitted by several states including Florida and Texas. In April 2002, with the threat of a veto from President Bush should Congress attempt to cap state homestead exemptions, the two sides came together and worked through several competing matters.[69] However, to date no compromise has been reached. Members of the conference committee met on May 22, 2002, but failed to report the bill out of committee because of a deadlock over a matter unrelated to homestead bankruptcy problems.[70] Then, on March 19, 2003 the House passed H.R. 975 by a vote of 315 to 113. The Bill is identical to the Conference Report from the 2002 Congress, except that it is stripped of the unrelated homestead language that prevented the bill from passing at the end of last year's lame-duck session. However, as of December 15, 2003, the Senate had yet to take any action on the Bill.

If the Senate approves H.R. 975 without significant changes, it may look significantly similar to the Conference Report that as of May 22, 2002 would significantly impact the ability of a person to move to Florida shortly before a bankruptcy filing (or any other state with favorable homestead provisions) to take advantage of its unlimited homestead exemption. It appears that the compromise version of the House Bill, H.R.333, would impact the exemption by capping the homestead exemption at $125,000, only if the debtor: (1) cannot meet a residence requirement of 40 months in a particular state before filing for bankruptcy; (2) is shown to have committed fraud or other criminal acts, such as violations of State or Federal securities regulations, prior to filing for bankruptcy (this provision appears to be aimed at situations such as Enron and WorldCom); or (3) is subject to pending criminal charges. Otherwise, in Florida, the unlimited homestead exemption would apply if the other requirements to qualify for homestead are satisfied. The bankruptcy court can look back 10 years for instances of fraud associated with a homestead exemption claim.[71] Much has been written on whether the compromise bankruptcy bill is fair even though it retains the unlimited homestead exemption.[72] It would appear that the new bill, if enacted, should avoid some of the eve-of-

[69] Bankr. L. Daily (BNA) (May 31, 2002).

[70] *Id*.; Greg Hitt and Christine Whelan, *Bankruptcy-Reform Bill Displays Still-Formidable Corporate Clout*, The Wall Street Journal Online, July 29, 2002.

[71] Bankr. L. Daily (BNA) (April 24, 2002).

[72] Dawn Kopecki, *Deal Paves Way for New Bankruptcy Law; House Vote Seen Friday*, The Wall Street Journal Online, July 26, 2002; Dawn Kopecki, *US House Expected to Adopt Harsh New Bankruptcy Laws*, The Wall Street Journal Online, July 26, 2002; Kathleen Day, *Hill Set to Toughen Bankruptcy Law*, The Washington Post, July 26, 2002; *Bankruptcy Reform Bill Moves Forward*, USA Today, July 26, 2002; Rob Wells, *Passage of Bankruptcy Bill Now Trickier for US Congress*, The Wall Street Journal Online, July 29, 2002; *US House Adjourns Without*

bankruptcy maneuvering that allowed debtors similar to those in the *Havaco* decision to use Florida's homestead as a successful technique to exempt significant assets from the reach of the Bankruptcy Court. Based upon the latest string of criminal indictments of corporate executives it is possible that legislators may be unwilling to accept a continued unlimited homestead exemption and we must be aware of such a possibility.

PLANNING

Once a resident satisfies all of the requirements described in this article, other planning issues remain. Deciding on the amount of equity to maintain in a residence is a very difficult decision. From an asset protection viewpoint, a homestead owned free-and-clear provides the greatest protection to a homeowner because his or her equity in the home is equal to its fair market value. However, many financial planners and CPAs argue that having too much equity in a homestead is wasteful because (i) the owner does not benefit from a mortgage interest deduction and (ii) the funds used to satisfy the debt may do better if invested elsewhere. These issues may create conflicts among a client's team of professionals. If asset protection is a significant client objective, it is recommended that the individual maintain the smallest affordable mortgage and the highest equity possible in the homestead. However, on occasion the client's financial planner and/or CPA criticize such planning and advise the client that they could benefit from investments that would generate earnings that would exceed the after-tax mortgage interest cost. It is important for the client to make an informed decision on whether to maintain a mortgage on his or her residence if asset protection is an important goal. The tax, financial and asset protection consequences of each alternative need to be considered. Because the homestead exemption protects the equity in a homestead, the greater the equity in the homestead, the greater the value that will be protected.

CONCLUSION

As discussed in this article, there are many traps for the unwary regarding Florida's homestead exemption. From a descent and distribution perspective, the homestead may pass in a manner contrary to the homeowner's intent if not properly devised. With respect to the valuation of the homestead for property tax purposes, the "Save the Homes" cap may not apply if not properly addressed. Finally, while it may appear that the Florida homestead exemption is unlimited for asset protection purposes, there are restrictions that are not commonly understood by the press and public. A Florida debtor cannot automatically assume that his or her homestead is exempt in its entirety from a forced sale for the benefit of creditors. Before a debtor can be confident that the homestead will survive attack by creditors, he or she must be sure that the residence satisfies applicable acreage requirements, be recognized as a homestead, and be titled properly. Furthermore, if the funds used to purchase the homestead were fraudulently obtained, an equitable lien may be imposed.

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Acting on Bankruptcy Bill, The Wall Street Journal Online, July 29, 2002; and Philip Shenon, *Vote on Bankruptcy Bill is Stalled by Abortion Provision*, The New York Times, July 30, 2002.

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Barry A. Nelson *is founder of the law offices of Nelson & Nelson, P.A. and The Victory School For Children with Autism, both in North Miami Beach, Florida. He is Florida Bar Board Certified in both Taxation and Wills, Trusts and Estates. He is also an adjunct professor at the University of Miami School of Law Graduate Tax Program and a Fellow of the American College of Trusts and Estates Counsel. He received his LL.M. and J.D. (cum laude) from the University of Miami School of Law. Portions of this article addressing Florida asset protection were adapted from an article published in the Florida Bar Journal in January and February 2003 written by Barry A. Nelson and Kevin Packman.*

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H:\ARTICLES\HOMESTEAD EXEMPTION\2004 NELSON & PRATT ARTICLE\2004-01 FINAL HOMESTEAD PITFALLS TRAPS - PRATT NELSON.DOC

Tax Folio No:

WAIVER OF HOMESTEAD

COMES NOW, _____, the spouse of _____, and states the following:

Whereas, _____ and _____ own a residence located at: _____, _____ County, Florida, and legally described as:

LEGAL DESCRIPTION

Whereas, _____ and _____ have transferred their interest in the residence to the _____ REVOCABLE TRUST DATED _____.

Whereas, notwithstanding this waiver, the undersigned understands that should _____ predecease the undersigned, the undersigned would have an ownership interest in the residence by virtue of the laws restricting the distribution of Homestead Property;

Whereas, the undersigned desires to waive this Homestead right, and retain no rights or interest in this residence owned by the _____ REVOCABLE TRUST DATED _____, nor any and other residences which may now or in the future become the Homestead of _____.

Now, therefore, in exchange for receipt of valuable consideration, which receipt is hereby acknowledged, the undersigned states as follows:

1. The undersigned releases all rights, claims, demands, or interest that the undersigned may have based on the undersigned's marriage to _____ in any real property of _____ because of the Homestead Property provisions of the Florida Constitution or any Florida Statute concerning the property as Homestead. The foregoing is intended to and shall be a waiver of all rights by the undersigned of any interest in the property of the other in accordance with Florida Statute 732.702 (2003).

2. Pursuant to Florida Statutes Section 709.08, Durable Powers of Attorney, the undersigned hereby appoints _____, as Attorney-in-Fact, to execute any and all documents necessary to accomplish this waiver in the future, should any signature be required. In the event that _____ dies, resigns, or becomes incapacitated, or is unable to continue serving for any reason, the Grantor appoints _____, to serve as Successor Attorney-in-Fact. In the event that _____ dies, resigns, or becomes incapacitated, or is unable to continue serving for any reason, the Grantors appoint _____ to serve as Successor Attorney-in-Fact. This Durable Power of Attorney shall not be affected by subsequent incapacity of the undersigned except as provided in Florida Statutes Section 709.08.

EXHIBIT A

Dated this _____ day of _____.

_____ _____
Witness _____

_____
Printed Name of Witness

_____
Witness

_____
Printed Name of Witness

State of _____)
) ss.
County of _____)

The foregoing instrument was acknowledged before me this _____ day of _____, by _____, who [ ] is personally known to me or [ ] has produced _____ as identification and who did not take an oath.

_____
Notary Public
Print Name:

My Commission Expires:

EXHIBIT A

DECLARATION OF DOMICILE AND CITIZENSHIP

TO THE STATE OF FLORIDA AND COUNTY OF _____:

_____, being duly sworn, deposes and says that this is my Declaration of Domicile and Citizenship in the State of Florida that I am filing this day in accordance and in conformity with Section 222.17 of the Florida Statutes:

I was formerly a legal resident of _____ and I resided at _____. However, I have changed my domicile to and am and have been a bona fide resident of the State of Florida since the ____ day of _____, _____, and I reside at _____,
_____ County, Florida, and this statement is to be taken as my Declaration of Citizenship, legal residency and domicile in the State of Florida, to the exclusion of all others.

I understand that as a legal resident of the State of Florida, I am subject to intangible taxes, that I must purchase Florida license plates for motor vehicles, if any, owed by me or my spouse, and that my estate will be subject to probate in the Florida courts, and that if I vote, it must be in the precinct of my legal domicile.

_____
_____
Address

STATE OF FLORIDA)
) ss.
COUNTY OF _____)

SUBSCRIBED, SWORN TO, AND ACKNOWLEDGED BEFORE ME this _____ day of _____, _____, by _____, who [ ] is personally known to me, OR [ ] has produced _____ as identification and has taken an oath.

_____
Notary Public; State of Florida
My Commission Expires: Print Name:

TO BE EXECUTED AND FILED WITH DEPARTMENT OF FINANCE,
DIVISION OF RECORDING

Penalty for perjury: Up to five (5) years in state prison and
$5,000.00 fine. Chapter 837.012, Florida Statutes.

EXHIBIT B