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# ESTATE PLANNER

*Spring 2003*

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## Administration of Family Limited Partnerships

**CARL S. ROSEN**

Throughout the past decade, family limited partnerships (FLPs) have become an increasingly popular technique among high wealth families because they can provide significant estate planning, asset protection and business succession benefits. If, however, the formalities of the FLP are not adhered to, the limited liability of the FLP can be jeopardized, and the Internal Revenue Service could take the position that the FLP is illusory, thereby preventing the desired tax consequences, and possibly creating additional taxes, interest and penalties.

In order to maximize the advantages of an FLP and avoid, or substantially reduce, Internal Revenue Service or creditor challenge, the FLP

*FLP continued on page 7*

## Family Feud: Deal With It Now or Later

**MICHAEL A. DRIBIN**

There are many unfortunate consequences of the death of a family member, but one of the more difficult is litigation concerning the administration of the estate or trust. When the litigation involves family members fighting each other, the consequences are not only serious from a financial point of view, but from an emotional perspective, as well.

### **What kinds of litigation can arise following one's death?**

One of the most common forms of litigation concerns a challenge

over the validity of the will or trust which disposes of assets at death. These challenges generally are based on alleged lack of capacity at the time of execution of the documents or on the basis of the exercise of undue influence. Such issues can draw heavily on resources and bring difficult allegations among family members.

Other forms of litigation may occur during the course of administration of a will or trust. These may include issues over the nature and quality of administration the

*FAMILY FEUD continued on page 7*

# Dealing with Real Property as Part of Your Estate Plan

ROSE PARISH-RAMON

The disposition and administration of real property as part of an estate plan pose unique concerns that, if not dealt with properly, can lead to unwanted pitfalls, which may not be discovered until after a person's death.

There are three forms in which an individual typically owns real property:

- 1) in the individual's name;
- 2) in the name of the individual's revocable or irrevocable trust; and
- 3) co-ownership with another person.

Each type of ownership has its advantages and disadvantages, and it is important that each advantage and disadvantage is considered when determining how to dispose of an interest in real property as part of a person's estate plan.

Under Florida law, if a person dies owning real property in his or her individual name, the real property interest must be probated before it can be dis-

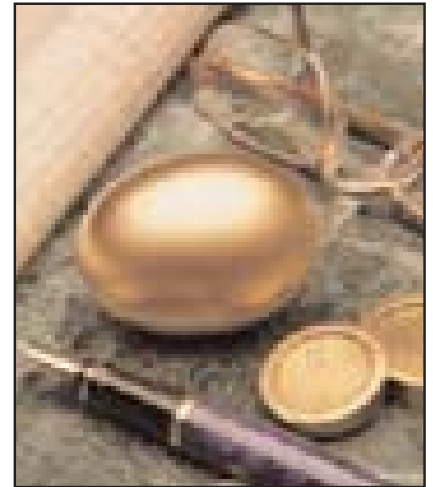
tributed to the person's beneficiaries. In addition, most of the documents that are filed in the Probate Court are available for the general public to view, so there is a lack of privacy. Consequently, many people will choose one of the other forms of real property ownership in order to avoid probate with respect to such property.

The revocable trust is a popular estate planning vehicle in which an individual can own real property and still avoid probate. The revocable trust allows one to have full control over the property during the person's life, and typically permits the property to be distributed more quickly upon the death of the person. However, in some cases, such as when homestead property is sold, it may be necessary to commence a probate proceeding to clear title to the property before it can be sold. In addition, trust ownership of real property located outside of Florida generally will circumvent

the need for probate of the property in the other state. However, there are disadvantages

to owning real property in a trust. Particularly, a Florida Bankruptcy Court recently held that homestead property that is owned by a revocable trust is not protected from the creditors of the grantor, as it would be if it were owned in the grantor's individual name.

Real property may also be transferred



to an irrevocable trust as part of an estate plan. A transfer of real property into an irrevocable trust is usually part of an estate plan that is designed to reduce one's estate tax liability. However, unlike the revocable trust, an irrevocable trust typically cannot be changed after it has been signed, and the grantor loses control over the real property that is held in the irrevocable trust.

A third form of ownership is co-ownership. There are three forms of co-ownership by individuals:

- 1) tenants by entireties;
- 2) joint tenants with rights of survivorship; and
- 3) tenants in common.

Tenants by entireties is a form of ownership that is unique to a married couple, and upon the death of the first spouse, the entire interest in the real property passes to the surviving spouse by operation of law, without any intervention by the Probate Court.

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## THE IDEA OF PROBATE MAKES MANY PEOPLE CRINGE, AND THEY WILL DO JUST ABOUT ANYTHING TO AVOID PROBATE

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tributed to the person's beneficiaries. The probate process has advantages, such as shortening the time period for creditors to file a claim against the assets of the deceased person's estate.

However, the idea of probate makes many people cringe, and they will do just about anything to avoid probate, for the probate process can be time consuming

Joint ownership with rights of survivorship can be enjoyed by anyone. Such type of ownership is used often by a parent and child(ren) in an effort to avoid probate upon the death of the parent. Property held jointly with rights of survivorship automatically passes to the surviving joint owner(s) upon the death of one owner. However, sharing ownership of real property with a child (or other person) can create significant problems.

When a parent adds a child as a joint owner, the parent has made a gift of an interest in the property to the child, and the parent may have to file a gift tax return with respect to the gift. After the transfer, the parent cannot sell or encumber the real property without the consent of the child. If the parent has more than one child and does not add all of the children on the new deed, intra-family disputes may arise after the death of the parent, especially, if the parent intended the one child to sell the property and distribute the proceeds among all of the children. But, the child whose name is on the deed becomes the sole owner of the property upon the death of the parent, and the child does not have a legal obligation to sell the property, irrespective of a moral obligation to do so.

In addition, during the life of the parent, joint ownership with a child may create additional problems, if the child is involved in a contentious divorce, or, if the child has creditors who may try to attach the real property interest. Accordingly, joint ownership, although it may avoid probate, is not always a safe haven and may create more problems than anticipated.

Similar problems can arise when ownership takes the form of tenants in common. In this type of ownership, using the parent and child example, the parent owns a one-half interest in the property, and the child owns a one-half interest in the property. If the child predeceases the parent, the child's share will have to be probated and will end up in the hands of the child's beneficiaries, who will then become co-owners with the parent.

One must be particularly careful when disposing homestead property. As indicated above, a Bankruptcy Court has held that homestead property held in a revocable trust may lose its protection from forced sale by the creditors of the grantor. Furthermore, the Florida Constitution and Florida statutes govern the devise of homestead upon the death of its owner, and if the law is not followed, the devise of homestead may be invalid.

Finally, when transferring real property from one form of ownership to another, it is important to ensure that the transfer does not violate the terms of any mortgage on the property, that the transferor obtains the consent of any homeowner's association or condominium association to the transfer and that the property insurance and the title insurance policy on the property are updated.

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## SPOTLIGHT:

# Estate Tax Reform – Where Are We? How Do We Plan?

DOUGLAS KNISKERN

In the spring of 2001, Congress passed and the President signed into law the Economic Growth Tax Reform and Reconciliation Act of 2001 (EGTRRA). EGTRRA contained a number of sweeping federal tax reductions to be phased in gradually over nine years. The much touted reason for EGTRRA was to give back to the American taxpayer some of the 1.7 billion dollar projected federal surplus that would be generated over the period of the tax cut phase-in. Unfortunately, even before the sad events of September 11, the projections of surplus had all but disappeared, and post September 11, the only thing projected and realized was red ink in ever-increasing amounts. Then came the war in Iraq, with a projected cost for the first six months of war and occupation at

budgets. The federal budget deficit for this year is projected at \$300 billion plus.

As a proposed cure for our economic ills, the President has asked for additional tax cuts, and the accelerated phase-in of some of the income tax cuts in EGTRRA. Tax cut advocates claim that the cuts will stimulate the economy, create jobs, and ultimately increase tax revenues to offset the tax cuts. Tax cut opponents claim that the current economic slow down is simply the economy correcting for the excesses of the late 1990s, that we cannot afford the tax cuts already on the books, and that betting on tax cuts to stimulate the economy and to offset the revenue loss from the cuts is a huge gamble that is likely to produce intolerably high deficits and

cost badly needed tax dollars for a whole host of critical needs.

Against the backdrop described

above, we do not pretend to know who is right or what the outcome will be. But, as tax advisors trying to do the best job possible for our clients, we believe that the future of the EGTRRA tax cuts, including estate tax cuts and ultimate repeal, passed in EGTRRA is uncertain at best. This uncertainty is particularly acute in the arena of estate tax planning, because effective estate tax planning fre-



quently is long range and requires many years to bear fruit.

Under EGTRRA as it now stands, the amount of property that can be passed down free of estate tax is due to increase incrementally between now and 2009 from \$1,000,000 to \$3,500,000. At the same time, the top estate tax rate is due to decrease incrementally over the same period from 50 percent to 45 percent. Then in 2010, the estate tax is to be repealed entirely, but only for one year. If Congress does not act between now and then, in 2011 the estate tax will come back at 2001 levels, meaning that only \$675,000 may be passed down estate tax-free, and the top estate tax rate will again be 55 percent. We believe that this result is too absurd even for Congress to tolerate, and that some sort of legislative change will happen before the one year repeal is allowed to come and go. But what?

At this point, we believe there is a likelihood that some, but not all of the future tax cuts in EGTRRA will

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**WE BELIEVE THAT THE FUTURE OF THE EGTRRA TAX CUTS, INCLUDING ESTATE TAX CUTS AND ULTIMATE REPEAL, PASSED IN EGTRRA IS UNCERTAIN AT BEST.**

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somewhere in the range of seventy five billion dollars. Politicians on both sides of the aisle have promised a Medicare prescription drug plan, Social Security is in dire need of repair, and the projected cost of homeland security at all levels of government will be in the hundreds of billions of dollars over the next ten years. All over the country, state and local governments are running deficit

ultimately take effect. Part of the President's proposed 2003 tax package as of this writing includes acceleration of income tax cuts enacted as part of the Act. That approach appears to have the most support in Congress. However, if that approach prevails and the economy does not respond robustly, and if the huge deficits some are predicting materialize, we believe that the rest of the tax cuts that were passed as part of the EGTRRA are in peril.

As for the future of the estate tax cuts, we believe that the increases in the amount of property that one can pass estate tax-free is likely the safest part of the current tax law. Our reasoning here is based purely on political pragmatism. Increasing the exemption to the \$2,500,000 to \$3,500,000 range will exempt a large number of estates from estate tax, but at the same time, it will cost the Treasury a relatively modest amount of revenue, thus allowing the politicians to provide tangible tax relief for a substantial number of constituents at a low revenue cost.

In our view, the next safest estate tax cut provision is the incremental reduction in the top estate tax rate from the current 50 percent (which is already five percent lower than the pre-EGTRRA rate of 55 percent) to 45 percent in 2009. In addition, if the estate tax is not ultimately repealed altogether, we would also not be surprised to see the size of the estate where the top estate tax rate becomes effective increased from the current \$3,000,000 to \$5,000,000 or even \$6,000,000.

The part of the estate tax relief provisions of EGTRRA that we believe is in most doubt is the ultimate repeal of the estate tax. If the economy bounces back and budget deficits are either relatively small, or if we again see surpluses, we believe there is a reasonably good chance for a permanent repeal. If, how-

ever, the economy is less healthy, and Washington believes that more tax revenue is needed, then, in our view, repeal of the estate tax may well be in trouble. Again, our reasoning here is pragmatic. If Washington believes that some of the EGTRRA tax cuts must be reduced or eliminated for the sake of revenue, then keeping an estate tax with a much higher exemption and a much lower marginal rate, and thus affecting very few voters, may be far more politically palatable than taking away other tax cuts such as income tax cuts that will affect a far larger number of voters.

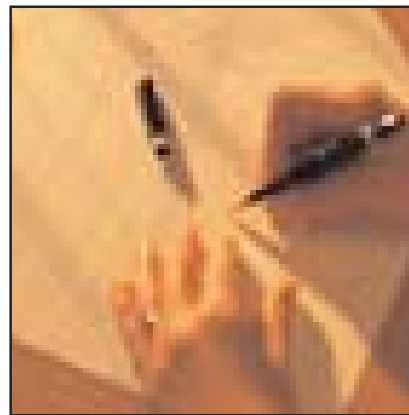
In the final analysis, no one knows what the future holds for the estate tax, except that the future is very uncertain. So how do we plan estates in the interim? Each estate plan is based on the facts and circumstances of the client and his or her family, so there will always be exceptions to general guiding principles. But, we believe that several principles will apply in most situations. These are:

**Clients should review their estate plans every few years.** This has always been important, but with tax law being a moving target, it is even more important now.

**For now, at least, plan as if there will be an estate tax in the future,** and be pleasantly surprised if there is not.

**Build as much flexibility as possible into the estate plan to allow it to be adapted to future facts and circumstances.** Since life is full of surprises, we believe this has always been true, but even more so now.

**Delay the payment of estate tax as long as possible.** For example, the federal estate tax marital deduction allows the estate of the first spouse to die to pass property to the surviving spouse tax-free, but it also requires the estate of the surviving spouse to include marital deduction property and potentially subject it to estate tax. Thus, the marital deduction has, in most cases, been an



estate tax postponement device rather than an estate tax avoidance device. Because estate tax rates are progressive, in the past it has been good tax planning, in some circumstances, to forego some of the benefit of the marital deduction in the estate of the first spouse to die, so that a lower estate tax overall is paid in the estates of both spouses. With the phased-in increases to the amount exempt from estate tax, this type of planning will become less important, and will likely disappear altogether.

**Be careful in making lifetime gifts that actually require the payment of gift tax.**

Unlike the estate tax exemption, the gift tax exemption under EGTRRA is frozen at \$1,000,000. In pre-EGTRRA times there was often an advantage in making gifts that actually exceeded the gift tax exemption and required the payment of gift tax, because if the donor lived for three years after the gift, the gift tax paid was out of his or her estate (a tax exclusive tax). However, with the possibility of estate tax repeal, in most cases, will not make sense to pay a gift tax now when assets might be able to pass at death without any estate tax.

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# Estate Planning for Owners of Closely-Held Businesses

NATHAN TOWNSEND

Congratulations, you have built your business from the ground up. It has taken a lot of hard work as you have concentrated all of your efforts and finances to making your business profitable. You probably have an organized business plan that looks into the future and anticipates opportunities in your market which will allow your enterprise to continue to grow. Suddenly, an accident takes your life. What happens now?

Ask yourself — who will continue to run the business? How will the business financially impact your family at your death? Does your family want your business after you die? If you do not have answers or are uncomfortable with the current answers to these questions, Broad and Cassel's Estate Planning and corporate attorneys are available for consultation and offer the following pieces of advice.

If you do have a plan in place, or are considering putting a plan in place, ask:

- When do I want to transfer my business?
- How will such a transfer be funded?
- Who has the skills to maintain and continue to grow my business?
- Are all of my children involved in the business? How will the ones outside the business enjoy the benefits of my life's work?
- How will my estate pay estate taxes?
- If my business is sold or trans-

ferred, how will my family support itself?

There are many solutions to these issues, depending on your specific answers to these questions. The following are a few of commonly used tools that may fit one or more needs for you and your family.

## ESTATE PLANNING DOCUMENTATION

If the business is to be kept in the family after the retirement or death of the owner, the proper estate planning documents must be in place to insure that the family members who will continue to run the business will be transferred the control they need. If all family members are not involved in the future of the business, re-capitalizing the business into voting and non-voting shares will allow everyone to enjoy in the future success of the business.

## LIFE INSURANCE

Purchasing adequate amounts of life insurance can also insure that there is liquidity in the estate to pay estate taxes. This will prevent having to sell the business or cause the estate to become indebted in order to pay the federal taxes.

## OWNERSHIP

If the business is not going to be kept within the family, identify potential buyers — such as key employees or other joint owners of the company. Once a successor is apparent, the next step is to determine what type of Redemption Agreement, Employee Stock Ownership Plan (ESOP) or Buy-Sell Agreement is



appropriate for your situation.

There are advantages and disadvantages to every strategy, and a full evaluation of your particular situation, and the needs and concerns of participants are necessary for a plan to be formulated.

Finally, regardless of how the business is sustained after your death, if an accident had happened yesterday, how would your immediate family, who depends on you for financial support, survive? The use of some or all of these strategies will provide the family with a good financial foundation to move forward. Surround your family with a team of trusted financial and legal advisors to insure that they receive the best advice on how to best enjoy and benefit from the financial security you have provided.

“Chance favors the prepared mind” is a quote that rings true in many settings. Preparing your business to succeed today and in the future requires the consideration of these issues today. By making the appropriate plans for your business and your family, you can be confident that nothing is left to chance.

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**FAMILY FEUD** *continued from cover*

meaning or interpretation of the documents, fiduciary accounts and tax issues. All of this litigation can be expensive, time consuming and very destructive of relationships.

There is no sure-fire way of avoiding this kind of litigation. The best way to deal with it, should it arise, is to have quality legal representation in dealing with the issues. Broad and Cassel has the probate and trust litigation experience necessary to deal with these kinds of litigation aggressively and effectively.

**How can this litigation be avoided?**

While there is no certain way of doing so, since anyone can commence a lawsuit, some "preventative medicine" helps reduce the risks. The most important component of this is for the estate planning counsel to meet independently

with the person drawing up the will or trust in order to assure that the person is expressing their true, independent wishes and that the individual appears to have the capability of making those decisions. Also, a well-drafted estate planning document is one which tends to avoid or minimize ambiguities which might result in different interpretations during the course of administration. Unfortunately, this can also lead to longer documents.

Many administrative problems can be avoided through careful selection of the fiduciary to administer the estate or trust. This fiduciary may be a person or institution, such as the trust department of a bank or a separate trust company. The presence of good documentation during the administration of the estate or trust can go a long way toward avoiding the likelihood of a beneficiary ques-

tioning the administration, or prevailing if the challenge comes forward. Expert legal representation of the fiduciary is critical, so that the fiduciary has a strong sense of what their legal obligations are and has an appropriate source to turn to for guidance.

Broad and Cassel, in its trusts and estates practice, offers the kind of services and experience which are described in this article. We urge you to contact your Broad and Cassel attorney with any questions you may have in this area.

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**FLP** *continued from cover*

should adhere to the following formation and administration guidelines:

- The FLP's general partner, on behalf of the FLP, should open a checking account to deposit FLP income and pay FLP expenses. Furthermore, only the officers and/or managers of the general partner should have authority to act on behalf of the FLP and draw on the checking account.
- Only investment assets should be transferred to the FLP. Accordingly, no personal assets (such as a principal residence, automobile, jewelry, or other personal effects) should be transferred to the FLP.
- Contributions of capital to the FLP by partners should be made pro rata based on each partner's respective interest in the FLP.
- Distributions of FLP assets to partners should be made pro rata based on

each partner's respective interest in the FLP.

- All written correspondence from the FLP should be on FLP stationery.
- To gain maximum estate tax benefits, no individual partner should own a majority interest in the general partner.
- Although the State of Florida does not require the FLP to file a state income tax return, the FLP must file an intangible tax return for all intangible assets owned by the FLP.
- The FLP, its general partner, and the limited partners must adhere to the form of the FLP, including but not limited to:
  - 1 — Dealing with the FLP as a separate and distinct entity;
  - 2 — Labeling all FLP assets with the FLP's federal tax identification number;
  - 3 — Not co-mingling FLP assets with that of any partner, or any other individual or entity; and



4 — Acting reasonably based on its intent, purpose and legal obligations.

The benefits of forming an FLP can be extremely beneficial for high wealth families. In doing so, however, the FLP must be maintained in accordance with the guidelines set forth above in order to avoid challenge by the Internal Revenue Service or other creditors.

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