WEALTH PROTECTION UNDER FLORIDA LAW

Ivan & Daugustinis
ESTATE AND TAX ATTORNEYS

I. WHAT IS WEALTH PROTECTION PLANNING?

Wealth protection planning is the implementation of a strategy to safeguard your family's assets and inheritance from litigation (including divorce), creditor claims, judgments, and forfeiture. There are a number of different strategies that can be used to shield your personal and business assets from liability. A proactive approach to wealth protection planning is necessary, as once your assets become threatened, it is often too late to take action.

II. WHO NEEDS IT?

Anyone can benefit from wealth protection planning, but it can prove to be vitally important for certain individuals. Creating an estate plan with a focus on wealth protection can be essential for:

- **High Net-Worth Individuals** – by definition, high net-worth individuals have more to lose. As a result, they are also significantly more likely to attract a lawsuit. Asset protection is vital to those with significant assets, as they have the potential to leave an inheritance that provides generational wealth to their family.

- **High Risk Professionals** – doctors, lawyers, accountants, and financial advisors are among those professions at most risk of a lawsuit. In fact, nearly half of physicians over the age of 55 report having been sued according to the American Medical Association.

- **Business Owners** – business owners often fall into the high net-worth category above, and therefore are more likely to be sued. Though some business entities shield owners from personal liability, it is not uncommon for owners to be required to give personal guarantees for some business debts.

- **Retirees** – many retirees lack the ability to re-enter the workforce to recover from a creditor claim or judgment.

III. FORMS OF WEALTH PROTECTION

a. FLORIDA CONSTITUTION

Florida homestead law under the Florida Constitution offers some of the strongest asset protection found under any state constitution. In general, most judgment creditors cannot force the sale of Florida homestead property to collect a judgment.

Florida homestead property is defined as a natural person's principal residence in the state of Florida, limited to one-half acre if located in a city or 160 acres if in an unincorporated county. In order to qualify for the protection, a person must (1) intend for the home to be their primary

residence, (2) live in the home, and (3) own the home or have a beneficial interest in the home.

There are certain types of judgment creditors that can foreclose on homestead property, as it is not protected from mortgage liens, mechanics liens from repairing or improving the home, homeowner's association dues, property taxes, and certain IRS liens. In addition, if the homestead property exceeds size limitations and is not divisible, then the homestead protection will only apply on a pro-rata basis (e.g. a one-acre homestead property worth $1M located in a city would be protected up to $500K).

b. PROTECTION UNDER STATE LAW

i. RETIREMENT PLANS

Most common retirement plans are creditor protected under Florida law. This includes employee retirement plans such as 401(k) and 403(b) accounts, as well as individual retirement accounts (IRAs). These protections continue for beneficiaries after the account owner's death.

ii. PREPAID COLLEGE PLANS

Prepaid college plans and 529 savings accounts are afforded protection in Florida. These protections apply for judgments against the owner or contributor of a qualified plan as well as the beneficiary. 529 plans are protected even if the owner of the plan has the ability to withdraw funds to spend on themselves (this usually carries a tax penalty, however).

529 plans can also be effective gifting vehicles, as a present gift of funds to a 529 plan account can be spread out over five years without using any of the donor's lifetime gift tax exemption. For example, a 529 owner can contribute $85,000 to a child or grandchild's 529 plan in 2023. If a gift tax return is filed and a special election is made, the $85,000 gift can be spread out over the next five years and qualify for the annual exclusion in each of the five years ($17,000 is the current annual gift tax exclusion amount). This allows an owner to give a larger initial gift that will begin to appreciate immediately instead of making gifts of $17,000 in each of the next five years and avoid using the owner's lifetime gift tax exemption. One should be mindful, however, that any additional gifts to the same beneficiary during the five-year period will be above the annual exclusion amount and will use the donor's lifetime gift tax exemption.

A 529 plan should not be gifted to if the contributor faces the prospect of bankruptcy in the near future. If a contributor to a 529 account or prepaid college plan files bankruptcy, all monies placed into the accounts for the two-year period immediately before filing bankruptcy will be subject to seizure.

iii. LIFE INSURANCE

Death benefits paid after an insured's passing are exempt from the insured's creditors under Florida Statutes Section 222.13 (2022), as long as the beneficiary of the policy is not the insured's estate. If the policy does not have a beneficiary, or if the beneficiary is the estate, the policy is no longer protected and will be subject to creditor claims in probate. Assuming proper beneficiary designations are made, death benefits are also protected from the beneficiary's individual creditors as well (with few exceptions).

The cash surrender value of a life insurance policy during the insured's lifetime is also not subject to forfeiture. Florida courts have also ruled that the cash value is protected even if the insured decides to cash out the policy. When doing so, it is often recommended to keep these funds segregated, as they could lose protected status if combined with other funds or if another asset is purchased with the proceeds. It is important to note that the policy *must be based on the life of the owner of the policy*, not another individual, in order for the cash value to be protected.

iv. ANNUITIES

Most annuities are afforded creditor protection in Florida under statutory and common law, as annuities are commonly used for retirement and estate planning. There are many types of annuity products available, and Florida courts have consistently interpreted state law in a liberal manner to offer protection for annuities. Much like life insurance, both the principal value of an annuity contract and the annuity payments are protected. Again, it is advisable to keep proceeds from an annuity segregated from other assets, as protection can be lost if commingled with other funds.

For example, a successful business owner in Florida purchases a $1M annuity contract that provides guaranteed payments for twenty years. The owner gets into a car accident and a $2M judgment is entered - an amount that far exceeds the business owner's auto insurance limits. The $1M annuity and stream of payments from that annuity remain protected and cannot be garnished by the judgment creditor.

Not all annuities are protected, however. An annuity purchased by a resident before moving to Florida may be vulnerable. If seeking asset protection in the form of an annuity product, be sure to consult with a licensed advisor who is experienced in this area.

Certain trusts with annuity features can also provide asset protection. See discussions of Charitable Remainder Trusts and Grantor Retained Annuity Trusts below for more information on this topic.

v. TENANCY BY THE ENTIRETIES

Tenancy by the entireties (TBE) is a legal arrangement where a married couple shares equal or

joint ownership in property and ownership automatically passes to the surviving spouse upon death. This form of ownership is only available in about half of the United States. In Florida, married couples are the only entity that can hold legal title as TBE. For TBE to be created, there must be (1) unity of possession; (2) unity of interest; (3) unity of title; (4) unity of time; (5) unity of marriage; and (6) unity of survivorship. It is strongly advised that married couples seeking to establish or maintain TBE status check with their financial advisor or financial institution to ensure proper ownership. If an account is not presently held as TBE, the account may need to be closed and an entirely new account opened with proper titling to be effective as TBE.

With few exceptions, property held as TBE cannot be garnished or attached by one spouse's individual creditors. For example, suppose a married couple in Florida owns a bank account as TBE. One spouse, a doctor, is sued for malpractice and a judgment is entered. That judgment creditor will not be able to enforce the judgment against the jointly owned TBE bank account.

vi. WAGE ACCOUNTS

Wages, earnings or compensation of the head of household are exempt from garnishment or attachment under Florida law. If such wages are deposited into a bank account and are traceable and identifiable, this "wage account" can be completely exempt from creditors. Florida law concerning wage accounts can be very tricky, so proper implementation and management of the account is vitally important. For that reason, one must ensure that the wage earner is the only person named on the account, and that only wages are deposited into the account. Florida statutes recognize that traceable wages are exempt for 6 months, so having the earnings go directly into an account labeled as a wage account will make it easy to trace the funds if needed. For married couples, it is often recommended to transfer wages to an account that is held jointly as TBE within 6 months of their initial deposit into the "wage account."

vii. BUSINESS ENTITIES

Choosing the ideal business entity is an important first step for business owners. Business structure has a significant impact on asset protection, with the below entities being the most common for owners with wealth protection in mind.

1. CORPORATIONS

Many people are familiar with the "corporate shield," whereby shareholders, officers, and directors of a corporation will not be held personally responsible for the liabilities of the corporation. Short of a finding that the corporation was formed for a fraudulent or illegal purpose, it is very difficult to pierce the corporate veil in Florida. For this reason, corporations are an attractive choice for business owners focused on wealth protection. However, there are significant downsides to forming a corporation, such as (i) strict reporting and record keeping requirements, (ii) lack of

charging order protection (see limited liability company discussion below) and (iii) potential double taxation at the corporate and individual level, though this can be alleviated if a corporation is eligible and elects to be treated as an S corporation.

2. PARTNERSHIPS

A traditional general partnership offers no asset protection - all owners face unlimited personal liability. To alleviate the concerns of unlimited liability for general partners, Florida law allows a general partnership to become a Limited Liability Partnerships (LLP). The LLP is a general partnership where the partners have protection against individual liability for the acts of the partnership.

For those with wealth protection concerns who are interested in investing in a business, a Florida Limited Partnership (LP) may also be a suitable option. There are two types of partners in an LP, general partners and limited partners. General partners usually play an active role in the management of the business, and therefore face unlimited personal liability, much like owners of a general partnership. On the other hand, limited partners are allowed to passively invest in the business and share in its profits. Because limited partners have little or no control over the management of the business, they are only liable up to the amount invested in the business.

For additional protection for the general partner in an LP, Florida law allows the LP to become a Limited Liability Limited Partnership (LLLP). Similar to how an LLP protects the general partners, an LLLP provides protection against individual liability for the general partner. However, an LLLP is organized like an LP, with general partners and limited partners. The important distinction between the two is that general partners are not held liable for partnership debts in an LLLP. Nevertheless, LLLPs are not recognized in all states, which can lead to exposure if a Florida LLLP conducts business in a non-LLLP state.

All Florida partnerships enjoy charging order protection (discussed in more detail below), where the sole and exclusive remedy for a creditor of the individual partner is a charging order against their transferrable interests and distributions.

3. LIMITED LIABILITY COMPANIES

Limited liability companies (LLCs) are becoming the most popular entity for business owners in Florida. Much like corporations, LLCs protect owners from personal liability associated with the LLC's business or property. If a judgment is entered against an LLC, creditors can only pursue assets that belong to the LLC, not those assets personally belonging to an LLC owner/member. In addition, Florida law generally protects the assets of an LLC from the LLC owner's creditors by limiting creditors to obtaining a "charging order" against the owner's interest in the LLC, which is a benefit not afforded to corporations. A charging order is a weak creditor remedy, as it only

allows a creditor to collect against the owner's share of LLC distributions if and when such distributions are made. A charging order does not allow the creditor to force distributions from the LLC, force the owner to sell his or her LLC interest, or obtain ownership of the LLC interest.

A creditor of the sole owner of a single-member LLC, however, is not limited to a charging order under Florida law, and may foreclose against the LLC and ultimately obtain the LLC assets. For asset protection purposes, it may be wise to create a multi-member LLC from inception or convert an existing single-member LLC to a multi-member LLC.

viii. TRUST PLANNING

1. REVOCABLE TRUSTS

In general, revocable trusts offer no asset protection for the trust creator (grantor) during their lifetime. Revocable trusts are designed to allow a grantor full access to the assets in trust during their lifetime, and therefore these same assets are fully accessible to creditors. However, if structured properly, revocable trust planning can include significant asset protection for beneficiaries following the death of the grantor. If a grantor chooses to have assets remain in trust for their beneficiaries, the resulting beneficiary trusts can be structured to prevent creditors from reaching trust assets.

For asset protection to be achieved, the beneficiary trusts must be drafted properly. This often means including "spendthrift provisions" and giving a trustee discretion over distributions from trust. A valid spendthrift provision in Florida restricts both voluntary and involuntary transfers of a beneficiary's interest, meaning a trustee cannot distribute assets to anyone other than the beneficiary. Trustee discretionary clauses can also bolster asset protection. A typical clause may give a trustee discretion to pay to the beneficiary only so much of the income and principal of the trust property as the trustee sees fit, or limit distributions solely for a beneficiary's health, education, maintenance, and support (HEMS standard).

This form of revocable trust planning can be structured as a "dynasty" or "generation skipping transfer tax (GST)" trust – a trust that passes wealth from generation to generation without incurring transfer tax. Upon hearing the term "dynasty trust," most people assume this type of planning is reserved for the Rockefellers or Vanderbilts of the world. However, many estate planning clients and their families can benefit from dynasty trust planning even without large estates.

In general, GST tax can be imposed when someone transfers property to a related person more than one generation younger than the donor (e.g. gift to grandchild). However, dynasty trusts are designed to take advantage of an individual's GST exemption (currently $12.92M, but scheduled to automatically reduce to $5M in 2026 plus an index for inflation). In this way, exempt funds can

be set aside in trust for children after a parent's death, but these funds will never be taxed in the child's estate and possibly even the estates of their children at their deaths. In other words, these exempt funds may pass down to future grandchildren or even great-grandchildren, free of both estate and GST tax, regardless of the future value of the funds.

In Florida, proper dynasty trust planning can also provide significant wealth and asset protection for generations, shielding the inheritance from the risks posed by divorce, malpractice, business failures and other creditors. It is vitally important to seek an experienced estate planning attorney to achieve the proper result.

2. IRREVOCABLE TRUSTS

As explained above, under Florida law, revocable trusts offer no protection for the grantor during their lifetime. However, if a grantor is willing to make a gift of assets to an irrevocable trust during their lifetime, the gifted assets can be protected. The gifted assets (1) must be for the benefit of another person, and (2) the gift cannot be revoked or taken back by the grantor. Again, with a goal of asset protection in mind, the irrevocable trust must be drafted properly (e.g. include "spendthrift provisions" and/or trustee discretionary clauses).

A Spousal Lifetime Access Trust (SLAT) is an irrevocable trust where one spouse ("grantor spouse") gifts assets to the SLAT with the other spouse as beneficiary ("beneficiary spouse"). The trustee (who may be the beneficiary-spouse) can make distributions from the SLAT to the beneficiary spouse during their lifetime, usually for health, education, maintenance and support. The SLAT also contains directions on how assets will be distributed on death of the beneficiary spouse, i.e., to children or trusts for their benefit (where, as discussed above, "dynasty trust" planning can be implemented). SLAT assets are protected under Florida law from both spouses' creditors. SLATs create significant wealth protection from lawsuits against the grantor, trustee and beneficiaries (including remainder beneficiaries), potentially protecting the assets in the event children or grandchildren divorce or remarry.

When creating a SLAT, the grantor spouse will use some (or all) of their lifetime gift tax exemption and will need to file a gift tax return. The Tax Cuts and Jobs Act of 2017 (the "Act") significantly increased the federal estate and gift tax exemptions, which stand at $12,920,000 per individual for 2023. However, the Act is set to expire on December 31, 2025, with the expectation that the exemptions will be cut in half. Taking advantage of the current favorable tax environment may be critically important for individuals and families with larger estates. The IRS has recently issued "anti-clawback" regulations regarding the Act, confirming that individuals will be able to use current gift tax exemption amounts and not be penalized if the exemption is reduced in the future. The implementation of a SLAT can be an effective way to utilize current tax exemption amounts before they disappear.

Irrevocable trusts are also commonly used in Medicaid planning. For those that fear nursing home costs will run through their life savings, a gift to an irrevocable trust can help to ensure assets will pass to the next generation. However, any gift to an irrevocable trust *must be made at least five years prior to the grantor applying for Medicaid*. If executed and administered properly, the gifted assets will not be counted as an asset when applying for Medicaid.

3. CHARITABLE REMAINDER TRUSTS

Charitable Remainder Trusts ("CRTs") allow an individual to gift property to charity, protect it from creditors, create an income stream for a term of years or for life, defer income taxes, generate an income tax deduction, and reduce federal estate tax exposure. A CRT is a tax-exempt entity; thus, in addition to being protected from creditors, assets held in the trust are not subject to income tax. Instead, the taxpayer only pays tax on annual distributions from the CRT to the extent the distribution consists of taxable income. There are two general categories of Charitable Remainder Trusts: Unitrusts ("CRUTs") and Annuity Trusts ("CRATs"). CRUTs pay a fixed percentage of trust assets to an income beneficiary, whether the value of the trust increases or decreases, whereas CRATs pay a fixed sum to the income beneficiary, regardless of trust value.

The operation of a CRT is best illustrated by example: A 65-year-old donor wishes to generate a lifetime income stream on funds that grow tax free and ultimately benefit his favorite charity upon death. The donor transfers $1,000,000 to a lifetime CRUT in 2023 that pays out 5% each year. Upon establishing the CRUT, the donor receives a charitable income tax deduction of approximately $455,540 (assuming a 4.6% Section 7520 rate applicable during the month of contribution). If we assume the CRUT assets grow at a 7% rate each year, and the donor dies 15 years after establishing the CRUT, (i) the donor receives annual unitrust distributions ranging from $50,000 in the first year to over $65,000 in the last year of his life, (ii) the more than $1,328,000 remainder value of the CRUT passes to his favorite charity, and (iii) the remainder value of the CRUT passing to charity is not subject to federal estate tax. To replace the value of assets passing to charity, the donor may choose to purchase life insurance with a death benefit equal to the expected amount of the CRT remainder. CRTs can be especially effective with highly appreciated assets, as assets gifted to a CRT are not subject to capital gains tax if sold by the CRT.

4. GRANTOR RETAINED ANNUITY TRUSTS

Grantor Retained Annuity Trusts (GRATs) can be a tax efficient way to move wealth to heirs while using a small amount, if any, of an individual's lifetime gift tax exemption. While generally associated with tax planning, GRATs can also provide asset protection due to their annuity-like structure. A GRAT is an irrevocable trust where a grantor contributes assets to the trust and retains the right to be paid an annuity for a specified term of years. In many cases, due to the IRS method for calculating the value of the grantor's retained interest in the trust and value of the remainder interest, GRATs can be "zeroed out" and use virtually none of the grantor's lifetime gift tax

exemption. When the GRAT term expires, the amount remaining in trust – the earned appreciation on the assets minus the annuity payments made – pass to the remainder beneficiaries free of estate and gift tax.

Again, the use of a GRAT may be best explained by example: a grantor creates a 3-year GRAT when the Section 7520 rate is 4.6% and funds it with $10,000,000 in marketable securities. The optimal annuity percentage is 36.4458% and the taxable gift is nominal per IRS calculations. The chart below illustrates the results:

Year	Beginning Val.	8% Growth	Annuity Pmt.	Remaining Val.
1	$ 10,000,000.00	$ 800,000.00	$ 3,644,580.51	$ 7,155,419.49
2	$ 7,155,419.49	$ 572,433.56	$ 3,644,580.51	$ 4,083,272.54
3	$ 4,083,272.54	$ 326,661.80	$ 3,644,580.51	**$ 765,353.83**

Based on an 8% rate of return, $765,353.83 would be distributed to the remainder beneficiary and removed from the grantor's taxable estate, while using virtually none of the grantor's lifetime gift tax exemption. In addition, due to being structured as an annuity, assets contributed to a GRAT and the resulting annuity payments are protected from creditor attachment (though annuity payments should be segregated to retain exempt status).

IV. OTHER CONSIDERATIONS

a. FRAUDULENT CONVEYANCES

A fraudulent conveyance is the transfer of assets with the intent to delay, hinder, or defraud a creditor. If a creditor can successfully argue that a debtor has made a fraudulent conveyance, the creditor may be able to get a court to set aside or void the transfer, resulting in the forfeiture of such assets to the judgment creditor.

Establishing the intent of a debtor can be hard to prove – a debtor will likely not admit to making a transfer with the purpose of avoiding creditors. As a result, Florida courts have established certain "badges of fraud" where a court can infer intent to defraud based on specific circumstances, including:

- **Transfer to an insider** – transfer of funds to a spouse, child, or other close relative or friend.
- **Maintaining possession** – debtor claims to have transferred an asset, but maintains custody of such asset.
- **Pending or potential litigation** – debtor was sued or facing litigation prior to transfer.
- **Timing** – incurring a substantial debt shortly before or after transfer.
- **Value of exchange** – debtor did not receive fair value for the transferred asset.

One notable exception to the fraudulent conveyance rule is the transfer of assets for the improvement or purchase of a homestead residence. Florida courts have routinely held that such a transfer - *even with the intent to defraud creditors* - cannot be set aside as a fraudulent conveyance. However, if the funds used to improve or purchase a homestead residence are acquired through fraud, the transfer can be voided (e.g. theft of money used for purchase).

b. FLORIDA DANGEROUS INSTRUMENTALITY DOCTRINE

As noted above, married couples in Florida enjoy powerful wealth protection with respect to assets held as tenants by the entireties (TBE). However, not all assets should be titled in this manner. Florida courts have created a "dangerous instrumentality doctrine," where the owner(s) of an "inherently dangerous instrument" are liable for any injuries or damages caused by the instrument. In Florida, automobiles and boats fall into this category. As a result, it is often recommended that they be titled solely in the name of the spouse who operates it most often.

As an example, let's assume one spouse gets into a serious car accident in a vehicle owned jointly by both spouses. A successful lawsuit would result in a judgment against both spouses. As a result, any bank accounts held jointly as TBE would become vulnerable. On the other hand, if the vehicle was owned solely by the spouse who was driving, the judgment would only be entered against that spouse. As noted above, one spouse's individual creditors cannot attach a judgment against assets owned as TBE, so the jointly owned bank account would not be subject to forfeiture.

c. BANKRUPTCY

For those who have accumulated sizable wealth and have asset protection concerns, bankruptcy will likely not be the answer as it typically results in the forfeiture of most assets to pay creditors. Bankruptcy law is complicated and can fill up an entire presentation – however, for purposes of asset protection, there are some scenarios where bankruptcy can make sense, including:

- **Falling behind on secured debt** – Florida's homestead protection does not apply when the debt is related to the homestead property. For those who fall behind on mortgage payments or property taxes, bankruptcy can be an option to make up those payments over time in order to avoid foreclosure.

- **Large judgments** – if a debtor faces a judgment well beyond their net worth, bankruptcy can be a way to start clean and protect future income and assets from seizure.

d. EXCESS LIABILITY/UMBRELLA INSURANCE

Homeowners insurance and auto insurance are standard safeguards for wealth protection purposes. For those with a heightened need for asset protection, umbrella insurance (or excess liability insurance) may be a solution worth looking into. An umbrella policy generally takes effect when limits have been reached under a homeowners or auto insurance policy. As an example, a car owner gets into an accident with serious injuries and medical bills total $600K, an amount that exceeds the car owner's insurance policy limit of $400K. At that point, the umbrella insurance policy kicks in and covers the remaining $200K, protecting the car owner's other assets.

In general, it is advisable to get an umbrella policy that covers the value of assets not already exempt – this is the amount that can be lost in a potential lawsuit. Umbrella policies also provide coverage over claims that arise outside of what a standard auto or homeowners policy may cover – e.g. lawsuits for defamation, invasion of privacy, wrongful eviction. Actions that are usually not covered include criminal acts, intentional acts that cause injury, or business losses (although a separate business policy can provide coverage).