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IS THE FLORIDA INTANGIBLE PERSONAL PROPERTY TAX A VOLUNTARY TAX?

Every Spring, it is not uncommon for clients to complain about having to pay the State of Florida a very unusual tax known as the Florida intangible personal property tax. The Florida intangible personal property tax (herein "intangible tax") is considered by many to be unusual because Florida is one of the few states that imposes the intangible tax. Since so many Florida residents have moved to Florida from other states, their first encounter with the intangible tax is one of surprise; what is this tax is all about? First examined will be some of the basics of the intangible tax.

The intangible tax is an annual tax imposed on the *just* valuation of all intangible personal property having a taxable situs in Florida, other than mortgage notes secured by Florida real property and certain intangible personal property that is specifically exempted by Florida law. Just value is synonymous with fair market value. Therefore, intangible personal property subject to the intangible tax generally include stocks traded on a stock exchange, closely-held corporate stock, interests in a limited liability company, corporate bonds, funds issued by state and local governmental agencies (other than obligations of the State of Florida, its political subdivisions and municipalities, and obligations of the United States Government), most mutual funds, unsecured notes, FNMA obligations and numerous other types of other intangible personal property. The fair market value of the items of intangible personal property having a taxable situs in Florida is measured on January 1st of each year. The due date for paying the intangible tax and filing the appropriate intangible tax return is June 30th, although discounts which reduce the amount of the intangible tax are available for taxpayers who pay the intangible tax at least thirty days prior to the due date.

Effective with January 1, 2006, the intangible tax is imposed at a rate of 1/2 mill ($.50 per $1,000) on the fair market value of the intangible personal property subject to the intangible tax. Therefore, an individual owning $5 million worth of intangible personal property subject to the intangible tax would incur a $2,500 intangible tax liability. Furthermore, individuals are entitled to an exemption from the intangible tax as to the first $250,000 of net value of intangible personal property subject to the intangible tax ($500,000 if filing jointly). Some taxpayers actually structure their investments in a manner to minimize or avoid the imposition of the intangible tax. Such an approach may yield a smaller economic return if the economic return from assets not subject to the intangible tax is less than the return on investments which are subject to the intangible tax, even after factoring in the analysis the intangible tax payable on those investments.

For individuals who pay relatively large amounts of intangible tax, there are planning strategies that will completely eliminate or minimize the imposition of the intangible tax. Generally,

the strategies will involve either establishing an irrevocable short-term trust of which the creator, i.e., the grantor, is not a trustee (oftentimes referred to as a "Flee Trust") or establishing a limited partnership in a jurisdiction other than Florida, where both the limited partnership and the general partner do not have a taxable situs in Florida. Obviously, the selection of the state in which to create the non-Florida limited partnership, should be a state that will not impose any income or intangible taxes on the limited partnership, its general partner and its limited partners. Moreover, with respect to a Flee Trust, as with other irrevocable trusts, the state of residence of the trustee may result in the imposition of state income tax on the trust's income.

If a Florida resident has a *beneficial interest* in a trust, including a non-Florida trust, and the *beneficial interest* falls within the definition of Section 199.023(7) of Florida Statutes, the Florida beneficiary must pay intangible tax on his or her equitable share of the trust. Section 199.023(7) of Florida Statutes defines the term *beneficial interest,* for purposes of the imposition of the intangible tax, as a vested interest (even if subject to divestment) which includes a current right to the trust income coupled with either (i) the power to revoke the trust, or (ii) a general power of appointment within the definition of Section 2041(b)(1) of the Internal Revenue Code of 1986, as amended. Therefore, if you are a beneficiary of a trust created by another person, you must pay intangible tax on your share of the trust if you have the right to the trust income <u>and</u> you have the right either to revoke the trust or to direct the distribution of the trust principal to yourself, your creditors, your estate or creditors of your estate and such power of appointment is not limited by an ascertainable standard.

A specific rule enacted by the Florida Department of Revenue addresses circumstances that would cause a Florida resident who creates a Flee Trust to be subject to the intangible tax relative to the assets comprising the trust estate of that trust. Basically, it is the position of the Florida Department of Revenue that a Florida resident grantor having any of the following rights will cause imposition of the intangible tax on intangible personal property owned by a trust:

(a) the right to revoke the trust, in whole or in part;

(b) the right to appoint or direct distribution of trust principal (other than by naming or removing beneficiaries pursuant to a limited testamentary power to add beneficiaries, other than the grantor's estate or creditors of the grantor's estate);

(c) the right to veto or approve proposed actions by the trustee with respect to the assets comprising the trust; or

(d) the right to remove or appoint trustees or trust protectors (persons who are empowered to remove or appoint trustees) without such power being limited to specific conditions not within the control of the grantor and the trust protector.

In my opinion, some of these grantor-retained powers which the Florida Department of Revenue posits will subject a Flee Trust to the intangible tax are not within the coverage of the laws enacted by the Florida Legislature pertaining to the intangible tax set forth in Chapter 199 of Florida Statutes.

Still, Florida residents can create short-term trusts pursuant to which the Florida resident-grantor can receive distributions of all income earned by the trust during the trust's existence.

Moreover, the trustee of the trust can be provided with the authority to also make distributions of principal to the grantor (and other beneficiaries of the trust, if any), as the trustee, in the trustee's discretion, determines to be allowable pursuant to the trust agreement, such as for health, education, maintenance and support. Although there is no specific length of time that the trust must be in existence, other than its period of existence including January 1st of the tax year in question, the trust certainly must be in existence long enough to ensure that the assets which are intended to be owned by the trust are legally transferred to the trust. Therefore, it is not unusual for the trust to last for a term of at least thirty to sixty days.

Much thought should go into deciding who will be trustee of the Flee Trust. The trustee can be an individual, a professional, an institution (such as a bank or trust company) or a combination of the foregoing. Remember, the grantor should not be the trustee. Moreover, it is important to verify that the state where the trustee (or each co-trustee) resides will not impose any taxes on the assets comprising the trust or the income generated from the investment of the assets comprising the trust. In other words, you do not want to *jump out of the frying pan into the fire*.

Another method for removing assets from the intangible tax environment is to establish a limited partnership in a jurisdiction other than Florida. As discussed, the selection of the jurisdiction in which to establish the limited partnership needs to be one that does not impose any taxes relative to the establishment, administration and distribution of the assets that will be owned by the limited partnership. Furthermore, unless you decide to have someone else be the general partner, it is usually advisable to create a corporation that will be the general partner of the limited partnership. The Florida resident will own the shares of stock issued by the corporation, thereby allowing the Florida resident to control the management of the limited partnership. Of course, the value of the stock of the corporate general partner will be subject to the intangible tax; therefore, it is important that the manner in which the corporation that serves as the general partner and the limited partnership itself are structured so it will result in only a minimal amount of value being reflected in the stock of the corporate general partner.

Limited partnerships can provide a variety of other benefits for clients, including a degree of asset protection relative to future judgment creditors, a vehicle for family members and others to pool investments for purposes of professional asset management, a mechanism for being able to make gifts to family members and others without having to give away specific assets or fractionalize ownership in specific assets, and a method to reduce the value of one's estate to minimize the imposition of federal estate taxes and state death taxes.

Generally, an individual who is paying intangible taxes of at least $5,000 or more is likely to perceive that he or she is obtaining a significant benefit in establishing either the Flee Trust or the limited partnership, from an **intangible tax avoidance standpoint**, considering the initial cost of establishing either device. Administration costs should also be considered, however, as they will be ongoing. For example, the cost of administering a Flee Trust will be directly affected by the selection of the trustee due to trustee fees that may be charged..

In April 2006, the Florida House and Senate approved legislation to repeal the annual Florida Intangible Personal Property Tax. At the time of writing this White Paper, the bill has not been presented to Florida Governor Jeb Bush for signature, but there is little doubt that he will sign the

bill repealing the tax. Further, the Florida 2006-2007 fiscal year budget recently signed by Governor Bush incorporates the $131 million revenue loss due to the repeal of the tax. The effective date of the repeal is January 1, 2007.

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