PRESERVING THE COMMUNITY PROPERTY CHARACTER OF MARITAL ASSETS WHEN MOVING TO THE UNITED STATES

By: Todd N. Rosenberg and Michael Rosenberg

Due to the current political and economic problems many South American countries are experiencing, it is common-place to find residents, citizens and domiciliaries of these countries immigrating into the U.S. in order to preserve, in their eyes, a "quality of life." Many of these individuals come from jurisdictions that apply community property laws to marital property, but the jurisdictions into which some find themselves moving utilize the separate property regime when it comes to marital property rights. Florida is an example of a common law state that applies the separate property regime. In making the move from a community property to a common law jurisdiction, there are various issues associated with "community property" that a married couple needs to consider, and earlier this year, we stressed the overall importance of these various considerations. The purpose of this article is to expand on that prior discussion, but with focus on the U.S. income tax benefits that can be obtained if the "community property" character of the martial assets are preserved after the move to the separate property jurisdiction.

Many common law states (such as Florida) have adopted the Uniform Disposition of Community Property Rights at Death Act (the "Act"). In general, the Act states that the character of community property marital assets will be respected unless the parties take certain actions to sever, or fail to act in certain situations so as to prevent a severance of, the community property. The Act not only assists in the disposition of the deceased spouse's assets, but also strengthens the argument that a married couple who have moved from a community property to a common law jurisdiction that applies the Act should still be entitled to the U.S. tax benefits associated with community property assets.

Assume that Husband ("H") and Wife ("W"), a married couple from Venezuela (a community property jurisdiction) have recently immigrated to Florida becoming U.S. taxpayers for all U.S. tax purposes (i.e., income, estate and gift tax). The major asset which they own is a business entity ("Entity") which was purchased several years ago while they were married for $1 Million. In meeting with U.S. estate planning counsel, H and W were advised to divide ownership of the Entity so that H and W each owned 50% in their respective separate names. Because the asset had appreciated greatly, this advice was given so that each would hold at least $2 Million in assets individually. Such advice is typically given in a common law jurisdiction in order to assure that both spouses have enough assets titled in their respective names in order to maximize each spouse's applicable exclusion amount (i.e., the amount which a U.S. person can die with before being subject to the U.S. estate tax). Thereafter, H passes away when the value of Entity is $4 Million, and under the terms of H's last will and testament, all of H's assets are left to W. In considering the U.S. income tax consequences that derive from this situation, one needs to determine the character of Entity. If by taking the actions described above, H and W severed the community property character of Entity (e.g., holding 50% separately in each of their individual names), then at the time of H's death W would inherit H's interest in Entity with a "stepped-up" basis (meaning the value of this 50% interest in the hands of W would be $2 Million). The basis in the interest W held prior to H's death would remain at $500,000 (1/2 of the $1 Million purchase price). At some point later in time, W finds herself needing liquidity for living expenses and thus sells the Entity for $6 Million. Upon the sale, W would be subject to the U.S. capital gains tax on $3.5 Million of appreciation ($6 Million less the $2 Million basis in the 50% inherited from H less the $500,000 basis in W's own 50% interest).

Had the parties taken affirmative steps to preserve the community property character of the Entity, the U.S. tax consequences would have been far more beneficial for W. If considered a community property asset, the U.S. tax law would have allowed a "stepped-up" basis as to both H's and W's interest in the Entity, and, therefore, when W went to sell the Entity only $2 Million of appreciation would have been subject to the U.S. capital gains tax (as upon H's death, W would have had a "stepped-up" basis of $4 Million as to both interests in the Entity). Indeed, this would have been a tremendous tax savings!

Upon immigrating into the United States (and into a separate property jurisdiction that applies the Act), a married couple in the situation discussed herein can take certain steps so as to preserve and thus achieve the "step-up" noted above. Such steps might include entering into a jointly settled revocable trust or a post-marital agreement wherein it is stated that the parties intend to preserve the community property character of the marital assets. The U.S. tax benefit discussed herein and the various planning options that can be utilized to achieve this benefit should always be considering when preparing the U.S. estate plan.

If you would like to contact the authors for further information, Michael Rosenberg is a Shareholder and Todd N. Rosenberg is an associate with the Coral Gables, Florida law firm of Packman, Neuwahl & Rosenberg and can be reached at (305) 665-3311.