

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 109 Excise Tax on Documents

SPONSOR(S): Jenne and others

TIED BILLS: IDEN./SIM. BILLS: SB 234

|    | REFERENCE                               | ACTION | ANALYST | STAFF DIRECTOR |
|----|---|--------|---------|----------------|
| 1) | Finance & Tax Council                   |        | Wilson  | Langston       |
| 2) | Criminal & Civil Justice Policy Council |        |         |                |
| 3) |   |        |         |                |
| 4) |   |        |         |                |
| 5) |   |        |         |                |

SUMMARY ANALYSIS

HB 109 clarifies the law governing the calculation of documentary stamp tax due on "short sale" real estate transactions. Due to ambiguous language in the existing statute, there has been uncertainty about what is included in determining the amount of consideration subject to the tax; specifically, there has been uncertainty over whether cancellation of debt in short sale transactions is "consideration" used to determine the tax due.

This bill provides that in short sale transactions, when the lender cancels indebtedness to the seller, the cancellation of debt is not consideration used to determine documentary stamp tax. HB 109 codifies the conclusion of a Department of Revenue (Department) technical assistance advisement stating that the Department would not collect documentary stamp tax on the cancellation of debt in certain circumstances.

The bill defines a short sale as a purchase and sale of real property where:

- The seller's interest in the real property is encumbered by a mortgage in an amount greater than the purchase price paid by the buyer.
- A mortgagee releases the real property from its mortgage for an amount less than the outstanding mortgage indebtedness.
- The releasing mortgagee does not receive, directly or indirectly, any interest in the property transferred.
- The releasing mortgagee, grantor, and grantee are dealing with each other at arm's length.

The bill also provides that the department may put into action rules establishing criteria governing whether parties to a short sale are dealing with each other at arm's length.

On February 24, 2010, the Revenue Estimating Conference (REC) adopted an estimate that the provisions of this bill would not have a fiscal impact on either state or local government revenues because the bill codifies existing Department procedures.

This bill will take effect July 1, 2010.

## HOUSE PRINCIPLES

Members are encouraged to evaluate proposed legislation in light of the following guiding principles of the House of Representatives

- Balance the state budget.
- Create a legal and regulatory environment that fosters economic growth and job creation.
- Lower the tax burden on families and businesses.
- Reverse or restrain the growth of government.
- Promote public safety.
- Promote educational accountability, excellence, and choice.
- Foster respect for the family and for innocent human life.
- Protect Florida's natural beauty.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. EFFECT OF PROPOSED CHANGES:

##### **Current Situation**

Section 201.02(1), F.S., currently imposes documentary stamp tax on documents that transfer an interest in Florida real property. The tax is calculated based on the "consideration" of the transfer. Consideration includes money paid or to be paid, the discharge of an obligation, and the amount of any mortgage or other encumbrance. The current tax on deeds and other documents related to real property is \$0.70 for each \$100 of consideration.

Subsections (6) through (9) of s. 201.02, F.S., provide exemptions and limitations to imposition of the documentary stamp tax. These include:

- Transfers of real property from a nonprofit organization to specified governmental entities;
- Transfers of a marital home between spouses or former spouses as part of an action for dissolution of marriage; and
- Contracts to sell the residence of an employee relocating at his or her employer's direction, when the sales contract is between the employer and the employee, or the employee and a person providing employee relocation services.

There is also a limitation applied to certain judicial sales of real property under a foreclosure order. The certificate of title issued by the clerk of court is subject to the tax; however, the amount of the tax is computed based on the amount of the highest and best bid received at the foreclosure sale.

For fiscal year 2008-2009, total documentary stamp tax collections were approximately \$1.12 billion, a 42.6 percent drop from FY 2007-2008. Revenue from the documentary stamp tax is distributed between the General Revenue Fund and various trust funds<sup>1</sup>.

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<sup>1</sup> Office of Economic and Demographic Research, The Florida Legislature et al., *Florida Tax Handbook, Including Fiscal Impact of Potential Changes* (2010), available at <http://edr.state.fl.us/taxhandbooks/taxhandbook2010.pdf> (last visited Feb. 28, 2010).

## Short Sales

A “short sale” is the sale of real property in which the purchase price is less than the outstanding debt secured by the property (i.e. a mortgage). In most short sale situations, the seller either is, or is likely to soon be, in default and the property securing the debt has decreased in value. In order to avoid foreclosure, the seller wants to sell the property as soon as possible.<sup>2</sup> Due to the recent downturn in the economy and limited availability to credit, the real estate market in Florida has experienced an increase in the number of short sales.

In the majority of real estate transactions, the lender receives full payment of the loan obligation and agrees to release its lien on the secured property upon the sale of the property. In these transactions, the amount paid by the purchaser for the property is consideration and subject to documentary stamp tax.<sup>3</sup>

However, in short sale transactions because the purchase price of the property is less than the outstanding loan balance, the lender agrees to receive partial satisfaction of the loan obligation with the remaining debt cancelled. This cancelled debt has value to the seller because the seller is repaying less than what the seller borrowed to purchase the property; as a result, the issue arises as to whether the amount of cancelled debt should be treated as consideration for the transfer and therefore included in calculations for documentary stamp tax purposes under s. 201.02, F.S.<sup>4</sup>

On September 23, 2008, the Department of Revenue (Department) issued a technical assistance advisement in response to a request for guidance in determining the correct tax on deeds for short sales in Florida. The Department concluded, “[W]hen the lender cancels indebtedness of the seller, that cancellation is not included in determining the amount of consideration subject to tax under s 201.02, Florida Statutes.”<sup>5</sup> In reaching this conclusion, the Department reasoned:

“The lender’s agreement to satisfy its lien and cancel a portion of the seller’s debt is a separate, unrelated transaction between the seller and the lender. The seller and the purchaser alone have entered into their contract for the transfer of real property. The lender is not related to either one of those parties and is not bound by any aspect of the contract between the seller and the purchaser.

Independently, the lender has agreed to satisfy its lien and cancel a portion of the seller’s debt. The lender is not related to or controlled in any way by either other party, and neither the lender nor any of its related parties is receiving any interest in the real property. The lender has merely evaluated its risk as a creditor of the seller and the decreasing value of the seller’s collateral, and the lender has made a business decision to cancel a portion of the seller’s debt in return for the current payment of a lesser amount. Section 201.02(1), Florida Statutes, does not clearly impose tax merely because the seller happens to be a party to both transactions.

...

Unlike other situations where an obligation is discharged in exchange for real property ..., it is at best unclear whether the Legislature intended to impose tax on the amount cancelled by the lender. When the application of a taxing provision is unclear or ambiguous, the Department is bound to construe that taxing statute narrowly, against the imposition of tax. See, e.g., State

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<sup>2</sup> Florida Dep’t of Revenue, *Technical Assistance Advisement No. 08B4-006, Documentary Stamp Tax – “Short Sales” of Florida Real Property*, 1 (Sept. 23, 2008), available at <https://taxlaw.state.fl.us/wordfiles/DOC%20TAA%2008B4-006.pdf> (last visited Feb. 28, 2010).

<sup>3</sup> *Id.* at 4.

<sup>4</sup> *Id.* at 3.

<sup>5</sup> *Id.* at 4.

*ex. Rel. Seaboard A.L.R. Co v. Gay*, 160 Fla. 445 (Fla. 1948). Thus, we construe the statute not to include the lender's cancellation of debt as consideration in the instant case. However, the Legislature may choose to clarify the application of the statute through legislation."

### Effect of proposed changes

This bill will clarify the law governing the calculation of documentary stamp tax owed when real property is conveyed via short sale. HB 109 creates s. 201.02(11), F.S., to provide that consideration does not include the unpaid indebtedness that is forgiven or released by a mortgagee holding a mortgage on the property. The bill defines a short sale as the purchase and sale of real property in which:

- The grantor's (seller's) interest in the real property is encumbered by a mortgage or mortgages securing indebtedness in an aggregate amount greater than the purchase price paid by the grantee (buyer).
- A mortgagee releases the real property from its mortgage in exchange for a partial payment of less than the outstanding mortgage indebtedness owing to the releasing mortgagee.
- The releasing mortgagee does not receive, directly or indirectly, any interest in the property transferred.
- The releasing mortgagee, grantor, and grantee are dealing with each other at arm's length.

This bill provides that the Department may put into action rules establishing criteria governing whether parties to a short sale are dealing with each other at arm's length. This bill further codifies the Department's advisement conclusion that in a short sale transaction, cancellation of debt is not consideration used to determine documentary stamps tax.

#### B. SECTION DIRECTORY:

**Section 1:** Creates s. 201.02(11), F.S., to provide that the taxable consideration for a short sale transfer does not include the unpaid indebtedness that is forgiven or released by a mortgagee holding a mortgage on the property. Additionally, the bill defines a short sale.

**Section 2:** Provides that Department of Revenue will adopt rules establishing criteria governing whether parties to a short sale are dealing with each other at arm's length.

**Section 3:** Provides an effective date of July 1, 2010.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

#### A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

No Impact. (See FISCAL NOTES)

2. Expenditures:

None.

#### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

No Impact. (See FISCAL NOTES)

2. Expenditures:

None.

#### C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

**D. FISCAL COMMENTS:**

On February 24, 2010, the Revenue Estimating Conference (REC) adopted an estimate that the provisions of this bill would not have a fiscal impact on either state or local government revenues because the bill codifies existing Department procedures.

**III. COMMENTS**

**A. CONSTITUTIONAL ISSUES:**

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to affect county or municipal government.

2. Other:

None.

**B. RULE-MAKING AUTHORITY:**

The Department of Revenue will have rule making authority that adopt rules establishing criteria governing whether parties to a short sale are dealing with each other arm's length.

**C. DRAFTING ISSUES OR OTHER COMMENTS:**

**IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES**