The Florida Senate

Interim Report 2009-113 *October 2008*

Committee on Finance and Tax

DOCUMENTARY STAMP TAX ON REAL PROPERTY TRANSFERS AFTER CRESCENT MIAMI

Issue Description

Documentary stamp tax collections are distributed to the General Revenue Fund and also to various trust funds (see page 3). In Fiscal Year 2005-2006, Florida's documentary stamp tax receipts peaked at approximately $4 billion, with $1.2 billion deposited into the General Revenue Fund. Receipts for Fiscal Year 2008-2009 are expected to be under $1.5 billion and the tax distribution to the General Revenue Fund is estimated to be $252.5 million. Receipts are estimated to remain below $2 billion through Fiscal Year 2010-2011.

The documentary stamp tax revenue contraction reflects a broad weakness in the real estate market. However, a growing number of real estate transactions are structured to allow for the transfer of property to an unrelated person without incurring the tax liability imposed on documents that convey an interest in real property. The tax can be avoided by transferring the controlling interest in an entity that owns real property. Transactions are structured to avoid the tax by conforming to the Florida Supreme Court's 2005 *Crescent Miami* opinion.[1]

Widespread structuring of real property transfers to avoid the stamp tax will reduce a significant revenue source that supports the General Revenue Fund. Given the judicial sanction for tax planning under current law[2] and the relatively low cost to structure transfers free from documentary stamp tax, the use of tax planning can be expected to increase. A growing percentage of high value Florida real property conveyances are expected to take advantage of the planning opportunity offered by the Court's opinion. Therefore, unchecked by statutory amendment, tax planning can be expected to reduce future stamp tax receipts.

During the 2008 session, legislation (CS/CS/SB 2040) was approved by the Senate to address the *Crescent Miami* opinion, but it died in the House without being heard. The Revenue Estimating Impact Conference determined that the bill would generate additional revenue of $51.7 million in Fiscal Year 2009-2010, and protect substantial revenue in future years.[3] The bill was not intended to overturn *Crescent Miami*. It was intended to limit the potential impact of the opinion. It would have allowed real property owners to shift their property into their own business entities and estate planning vehicles without requiring them to pay documentary stamp tax as if they were selling their property to themselves.

As a practical matter, the legal basis for imposing documentary stamp tax remains largely unchanged since the tax was enacted in 1931. The legislature has options if it chooses to curtail tax planning activity premised on *Crescent Miami*. The method most widely used by other states to close this type of planning "loophole" is to impose a tax on the sale of a controlling interest in an entity that owns real property.

[1] *Crescent Miami Center, LLC v. Florida Department of Revenue*, 903 So.2d 913 (Fla. 2005).
[2] "Tax planning" is the use of a method – typically stressing form over substance - to legally avoid tax and is contrasted with an illegal tax evasion scheme.
[3] Estimates of the fiscal impact of proposed bills are published at: http://edr.state.fl.us/conferences/revenueimpact/impact.htm

Background

The Tax on Deeds and Other Conveyances of Real Property

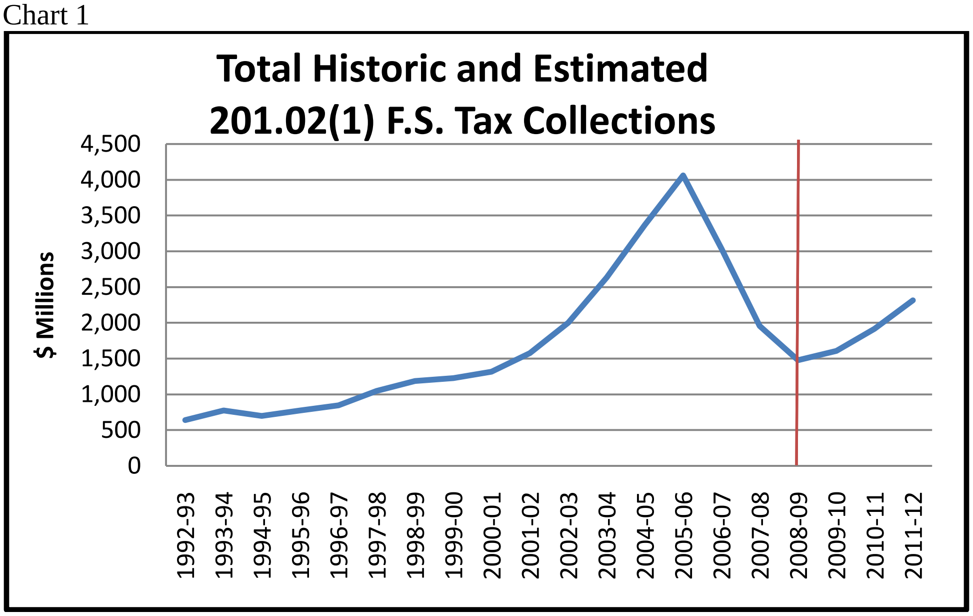
The documentary stamp tax is imposed on deeds or other documents that convey an interest in Florida real property.[4] A similar tax (not the focus of this report) is levied by section 201.08, F.S., on certificates of indebtedness, promissory notes, wage assignments, and retail charge account agreements. Florida first enacted a documentary stamp tax in 1931.[5] Today the statewide tax rate is 70 cents on each $100 of consideration paid in exchange for real property by a purchaser. At current statewide tax rates, $1,400 in tax is due on the sale of a $200,000 home. Since Miami-Dade County imposed an additional surtax of $0.45 per $100,[6] the stamp tax due on the conveyance of a $10 million commercial property in that county is $105,000.

According to a bulletin issued by the Federation of Tax Administrators in 2006, thirty-five states plus the District of Columbia impose a tax on the transfer of real property.[7] In California, Louisiana and Ohio the tax is imposed by local governments. Other states permit at least some localities to impose tax in addition to the statewide tax. Tax rates range from 0.01 percent to 2.2 percent, and the rate is 1.0 percent or higher in seven states and the District. In fifteen states, the tax yielded less than $20 per capita in 2004. The per-capita yield exceeded $100 in four states, including Florida ($111.99).

Tax Revenue Collections and Estimates

The Revenue Estimating Conference's August 2008 forecast for documentary stamp tax revenue reflects declining construction and real-estate activity.[8] Fiscal Year 2008-2009 collections are estimated to be only 36% of the collection level reached during the Fiscal Year 2005-2006 peak. As shown in Chart 1, adverse economic conditions are expected to last into 2009.

Chart 1



[4] Section 201.02(1), F.S. *See generally*, *Florida Tax Handbook: Including Fiscal Impact of Potential Changes*, 53 (2008).

[5] The Florida stamp tax was originally patterned on the federal documentary stamp tax levied on conveyances of realty. While there were "material differences in the wording of the federal and state statutes…," *Culbreath v. Reid*, 65 So.2d 556 (Fla. 1953); *Choctawatchee Electric Coop., Inc. v. Green*, 132 So.2d 556 (Fla. 1961), Florida courts did cite federal judicial opinions until shortly after the federal tax was repealed in 1966.

[6] In 1983, the Legislature authorized Miami-Dade County to levy a discretionary surtax on deeds. In Miami-Dade County the current tax rate is $0.60 on each $100 of consideration for a single family residence. An additional $.045 surtax is imposed on all other real property transfers. Section 125.0167, Fla. Stat.

[7] FTA Bulletin, *State Real Estate Transfer Taxes*, Federation of Tax Administrators (February 16, 2006).

[8] Revenue Estimating Conference, Documentary Stamp Tax Revenues. Available at: www.edr.state.fl.us (last visited August 15, 2008).

Stamp Tax Distributions

All proceeds from the documentary stamp tax went to the General Revenue Fund until 1967. That year a surtax was imposed on documents transferring realty with the proceeds going to the Land Acquisition Trust Fund. The surtax was repealed in 1979 and replaced by an increase in the general tax rate with a specific amount earmarked for distribution to the Land Acquisition Trust Fund. Since 1979, increases in the documentary stamp tax rate have been used to fund several programs, including the acquisition of environmentally sensitive land (Preservation 2000 and Florida Forever debt service funding), the provision of state infrastructure and the construction of affordable housing.

Generally, the distribution scheme can be divided into two fund groups.[9] The first fund group is the general revenue group. It receives 63.31% of total tax proceeds after deduction of the General Revenue Fund service charge (7%) and an administrative cost deduction ($10.3 million). This revenue is used to fund debt service for environmentally sensitive land purchases under the Preservation 2000, Florida Forever and Save Our Everglades' projects. The debt service commitment is fulfilled before other distributions are made. Once the debt service amounts have been set aside, the State Transportation Trust Fund, a water protection fund, an ecosystems management fund and other funds in this group are funded under a percentage calculation that is capped at a fixed dollar amount for each fund. Any remainder is distributed to the General Revenue Fund.

The second group includes trust funds for land acquisition, invasive plant control, water quality assurance and various state and local housing programs. Most funds receive a percentage distribution with a fixed dollar cap. Amounts calculated to be above the individual fund caps are distributed to the General Revenue Fund.[10]

Imposition of Tax Pursuant to Subsection 201.02(1), Florida Statutes, Prior to 1990

Apart from grammatical changes and several rate increases, the first two sentences of subsection 210.02(1), F.S., have remained substantially unchanged for over seventy-five years, and provide:

> (1) On deeds, instruments, or writings whereby any lands, tenements, or other realty, or any interest therein, shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser, or any other person by his direction, on each $100 of the consideration therefor the tax shall be 30 cents. When the full amount of the consideration for the execution, assignment, transfer, or conveyance is not shown in the face of such deed, instrument, document, or writing, the tax shall be at the rate of 30 cents for each $100 or fractional part thereof of the consideration therefor.

This language has been the subject of numerous judicial interpretations. The courts have repeatedly been asked to consider the meaning of its various words and phrases such as: "transferred," "conveyed to . . . the purchaser," and "consideration." As discussed below, early rulings still have precedential value,[11] but courts continue to be asked to determine whether particular transactions are taxable.[12]

Principal Judicial Opinions Issued Before 1990

In *State ex rel. Palmer-Florida Corporation v. Green,* 88 So.2d 493 (Fla. 1956), the Florida Supreme Court determined that a transfer of title to real property by a corporation to its shareholders was not subject to documentary stamp tax because the shareholders were not "purchasers" within the meaning of the statute. The corporation holding title delivered a deed to its shareholders in proportion to their ownership of the corporation. The court held that the shareholders did not pay a reasonably determinable consideration for the conveyance. The

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[9] Chapter 2008-114, Laws of Florida (2008), revised provisions relating to the distribution of the excise tax on documents.

[10] General information is available at: http://edr.state.fl.us/conferences/revenueimpact/2008/pdf/page%20575-579.pdf (last visited September 10, 2008).

[11] *E.g., De Vore v. Gay,* 39 So.2d 796 (Fla. 1949)(Future payment of rent is contingent, not of reasonably determinable value and therefore, not subject to stamp tax.); *Culbreath*, 65 So.2d at 558 (Where deed conveys by gift there is consideration, but not of determinable value).

[12] Litigation is currently pending in district court, *TPA Investments, LLC v. Dep't. of Rev.*, Case No. 2D07-6039(2nd DCA), that attempts to overturn *Dep't. of Rev. v. PMR Resorts, Inc.*, 868 So.2d 621 (Fla. 2nd DCA 2004) (Tax due on shareholder transfer of property to corporation when corporation had been a guarantor on the mortgage.).

Court found no legal support for measuring the tax due by the value of the land and considered the conveyance to be "a mere book transaction." *Id*. at 495.

Twenty years later, the Florida Supreme Court again addressed subsection 201.02(1), F.S., in *Florida Department of Revenue v. DeMaria,* 338 So.2d 838 (Fla. 1976). This time the property transferred by a corporation to its sole shareholder was subject to a mortgage. The opinion held that the transfer shifted the economic burden and benefit supplying the consideration required by subsection 201.02, F.S.[13] The "purchaser" obtained the property for an "exchange in value" resulting in a "reasonably determinable consideration." Therefore, to the extent of the mortgage, the transaction was subject to tax.[14]

In *NCNB National Bank of Florida v. Department of Revenue*, 523 So.2d 738 (Fla. 2nd DCA 1988), the issue was whether the assumption of a debt with no release of the original mortgagor qualified for an exemption. Section 201.09, F.S., exempts notes given in renewal of an existing promissory note. The law has since changed, but prior to 1990, the statute offered an exemption when the renewal note continued the identical contractual obligations of the original promissory note without specifically mentioning the addition of obligors.[15]

The facts in this case revealed the availability and use of renewal notes as a specific tax planning tool. Over an eight year period a landowner borrowed approximately $18 million secured by real property. Then a corporation purchased an undivided one-half interest as tenant in common in the property. The purchase was made subject to the mortgages and the corporation agreed to pay one-half of the secured debt. [16] Sometime later, the parties agreed to consolidate these notes with a renewal note including an assumption of the debt by the corporation.[17] The individual was not released from the debt. The court determined that the renewal note met the qualifications for the exemption from tax since it did not enlarge the obligation. The demonstrated ability of a third party to assume a mortgage tax free was a significant tool for tax planning and was one of the items addressed by the Florida Legislature in 1990.

Pre-1990 Administrative Guidance

In 1980, the Department of Revenue considered a purchase and sale agreement in which Marco Island Corporation and Hide-A-Way Beach, Inc., were merged and Marco Island Corporation was dissolved.[18] Hide-A-Way, the surviving entity, was left with the assets including real property. The purchase and sale agreement was executed and the transaction closed on December 28, 1979. The mortgage underlying the purchase was executed January 10, 1980, and recorded the next day. The Articles of Merger were filed on January 14, 1980. Relying on Rule 12B-4.14(8), Florida Administrative Code, (Statutory Merger) the Department determined that "all events necessary to the merger were completed and evidenced the intention of the parties to be a statutory merger…." Since the transfer was effectuated by operation of law, the Department ruled that no stamp tax was due on the conveyance pursuant to subsection 201.02(1), F.S.

1990 Amendments to the Stamp Tax

By 1990, judicial opinion was unambiguous that when a corporation transferred real property to a shareholder, absent any other consideration, the shareholder would only be a "purchaser" to the extent that the economic burden of the outstanding mortgage balance was shifted at the time of the transfer.[19] The search for a "purchaser" and an "exchange in value" would focus on the moment of the purported conveyance. The search for consideration is not confined to the four corners of the document conveying the property however. To this extent, the courts acknowledged that real estate transactions can take place sequentially and be structured to qualify as a "mere book transaction."

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[13] *Id.* at 840. The opinion compares the federal documentary stamp tax statute, 26 U.S.C.A. s. 4361 with sec. 201.02(1), and cites to a similar conclusion reached in *Greyhound Corp. v. United States*, 208 F.2d 858 (7th Cir. 1954).

[14] *Id. See also, Kendall House Apartments, Inc. v. Dep't. of Rev.,* 245 So.2d 221 (Fla. 1971).

[15] Chapter 90-132, s.11, at 454, Laws of Florida, prohibits the tax exempt addition of obligors to a renewal note.

[16] The opinion does not state whether the tax imposed by sec. 201.02(2) was paid on the sale of the tenancy in common.

[17] The loan consolidation was incident to the creation of an additional note that is not relevant to the discussion.

[18] *Marco Island Trust v. Dep't. of Rev.,* Case No. DOR-80-2(10/6/1980). *See also*, TAA 82(B)4-017(12/3/1982).

[19] *Compare*, *PMR Resorts, Inc.*, *supra*, *with, American Foam Industries, Inc. v. Dep't. of Rev*., 345 So.2d 343 (Fla. 3rd DCA 1977)(Taxes are due only once on the same encumbrance regarding the same person.).

Due to tax rate increases and rising property values, the stamp tax became a more significant closing expense for larger transfers. In response, sellers and purchasers were incorporating planning techniques to reduce, or minimize the tax. In 1990, after considering points raised by the Department, language was added to the statute to define "consideration."[20]

> For purposes of this section, consideration includes, but is not limited to, the money paid or agreed to be paid; the discharge of an obligation; and the amount of any mortgage, purchase money mortgage lien, or other encumbrance, whether or not the underlying indebtedness is assumed. If the consideration paid or given in exchange for real property or any interest therein includes property other than money, it is presumed that the consideration is equal to the fair market value of the real property or interest therein.

Following the enactment, the Department amended the Florida Administrative Code ruling that tax is due on a conveyance of unencumbered realty from a shareholder to a corporation in exchange for stock.[21] Similarly, it ruled that tax was due on a conveyance of unencumbered realty from a partner to a partnership in exchange for an ownership interest, or as a capital contribution.[22]

However, one group of commentators argued that the legislation "failed to treat a contribution of real property to an artificial entity as a taxable transaction; and the new statute failed to define the term "purchaser." The first sentence of the statutory amendment codified existing law. The second sentence limited the new definition of "consideration" to situations where the "consideration paid or given in exchange [for the document conveying title]…includes property other than money…." Consequently, they felt that "the statutory fix does not literally address transfers for which nothing is given in exchange…."[23] If this reading prevailed, the Department's new rules could be shown to lack statutory authority.

Tax practitioners asked the Department for advice about structured transactions. Technical Assistance Advisement (TAA) No. 95(M)-002, issued February 27, 1995,[24] describes a complicated transaction including assignments, partnerships, mergers, debt assumption, renewals, new lenders and monetary contributions. Two limited partnerships, consisting of multiple managing and general partners, asked about using a series of steps to transfer encumbered property for consideration without paying tax on a written a obligation backed by that real property.

It appears that the newly formed entities obtained real property, then renewed and assigned the debt to a new lender. A third party contributed $53 million to the new entities and received an ownership interest. The original parties forming the entities received cash totaling $27 million and maintained percentage interests in the new entities. Certificates of merger were recorded in each county where property was located and assumption agreements were executed in favor of the new lender. The ruling was that tax was not due on the transfer under section 199.133, F.S. (non-recurring tax on notes/obligations to pay money backed by real property), subsection 201.02(1), F.S., or section 201.09, F.S., because of specific exemptions that applied to each step of the transaction.

In a 1996 declaratory statement, *In re Petition of Gladman*, Case No. DOR 96-002 DS, July 10, 1996, the Department held that the transfer of unencumbered real property to a family limited partnership having no other significant assets was subject to tax based on the fair market value of the property. The petitioner owned the unencumbered property. When transferred, the property comprised over 99 percent of all contributions to the partnership. The petitioner's interest in the partnership was 98.2 percent. Four other individuals were limited

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[20] Barton, et al., *Kuro and Muben-Lamar In the Eye of the Beholder?*, The Florida Bar Journal, Vol. LXXVI, No. 5, p. 49 (May 2002). Ch. 90-132, s. 7, at 451, Laws of Florida. Ch. 90-132 also amended sec. 201.02(5), Fla. Stat., concerning conveyances of partnership property to a partner from a partnership. *Id.* at 452.

[21] Rule 12B-4.013(7), Fla. Admin. Code.

[22] Rule 12B-4.013(10), Fla. Admin. Code. *See also*, Declaratory Statement, Case No. DOR 96-002 (DS) (7/10/1996) (Deed conveying unencumbered real property to a family limited partnership subject to tax.).

[23] Barton, et al.

[24] *See also*, TAA No. 99(b) 4-018 (12/20/1999). A TAA response has no precedential value or benefit except as to the taxpayer making the request and is binding on the Department only based on the facts as provided. Section 213.22, Fla. Stat.

partners and they, along with the general partner divided the remaining interests. The petitioner retained beneficial and equitable ownership of the property. However, the Department held that "[i]n exchange for her individual real property, petitioner receives an intangible personal property interest; she no longer is the owner of the real property." On this basis, the Department ruled the documentary stamp tax on the transfer of real property was due. *Id*. On appeal, the First District Court affirmed the declaratory statement without opinion.[25]

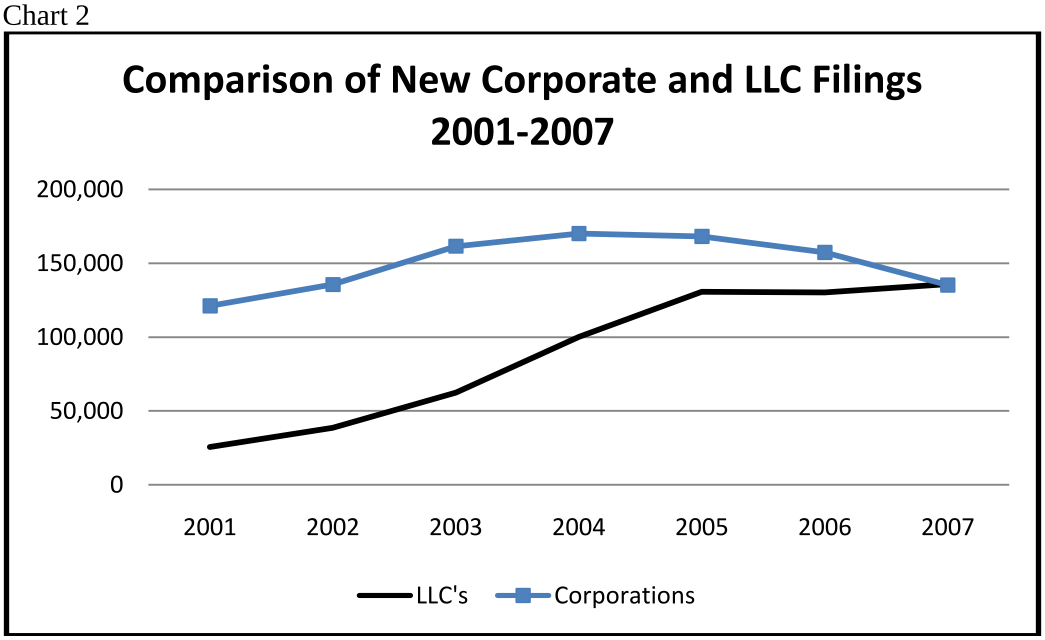
Judicial Opinions Issued After the 1990 Legislation

It wasn't long before the Department was in court again defending its adopted rules. *Kuro, Inc. v. Department of Revenue*, 713 So.2d 1021 (Fla. 2nd DCA 1998), considered a transfer of real property by a father and son, each holding equal shares in a corporation and in unencumbered real property. They transferred the real property to the corporation. The district court ruled that there was no consideration for the transfer of unencumbered real estate from the father and son to the corporation because the beneficial interests in the property remained the same.[26] The court noted that "[a]n analysis of whether there was a purchaser in many respects is a mirror image of an analysis of whether there was consideration."[27]

In *Muben-Lamar, L.P. v. Department of Revenue*,[28] a limited partner (Company) formed a new limited partnership with two general partners, one of whom was an affiliate. Company and its affiliate held a 99 percent interest in the new limited partnership. The nonaffiliated general partner contributed a promissory note to the new limited partnership into which the Company transferred unencumbered real property. The district court held that the Company received consideration in exchange for its contribution measured by the agreed value of the property conveyed. The court's majority found its decision to be in conflict with *Kuro*. This perceived conflict would not be resolved until the Third District Court of Appeal's decision in *Crescent Miami*[29] was accepted on appeal, and a decision was handed down by the Florida Supreme Court in 2005.

In addition to disagreement with the Department's rules, the influence of limited liability companies (LLCs) on tax planning was beginning to have an impact during this period. LLCs were authorized in Florida in 1982, but not widely used until the Internal Revenue Service changed certain regulations to permit "pass-through" tax status in 1997. Florida also provided an exemption from corporate income tax for such pass-through entities in 1998. Since then, use of the LLC business entity form has grown in Florida as seen in Chart 2.

Chart 2



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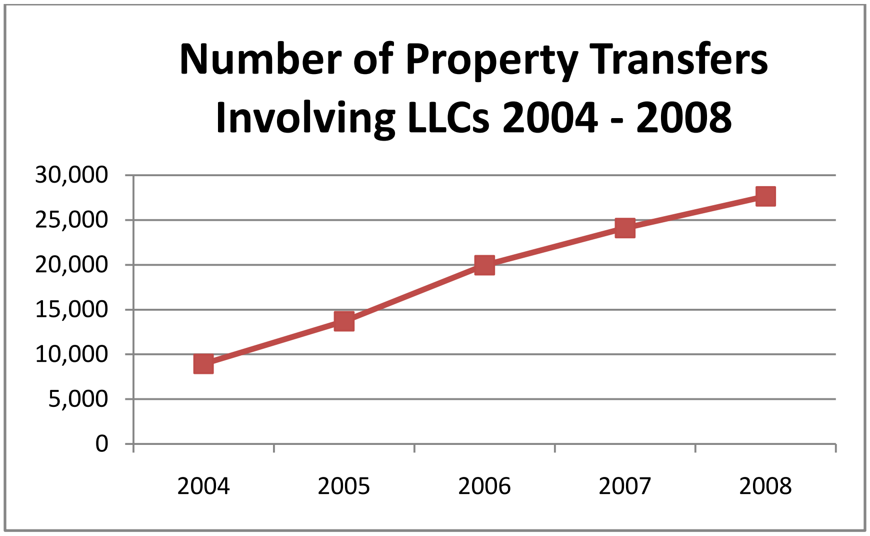
[25] *Gladman v. Dep't of Rev*., 693 So.2d 34 (Fla. 1st DCA 1997).
[26] *See also*, State, Dep't. of Rev. v. Ray Const., 667 So.2d 859 (Fla. 1st DCA 1996).
[27] *Id*. at 1022.
[28] 763 So.2d 1209 (Fla. 1st DCA 2000), *review granted*, 779 So.2d 272, *review dismissed*, 789 So.2d 337 (Fla. 2001).
[29] *Crescent Miami Center, LLC v. Dep't. of Rev*., 857 So.2d 904 (Fla. 3rd DCA 2003).

Most LLCs are not formed solely for purposes of documentary stamp tax planning. The LLC form has significant utility beyond any advantages for documentary stamp tax planning. The LLC form is a flexible and efficient way to shield assets from creditors, or to simplify the transfer of estate assets.[30] Additionally, LLCs are well suited for use in structured transactions.[31] Chart 3 represents the number of properties transferred during a given calendar year where the tax role information shows real estate ownership by an "LLC."

Chart 3



The *Crescent Miami* Opinion - Tax Can Be Avoided on the Transfer of Unencumbered Property

In 2005, the Florida Supreme Court accepted jurisdiction over the pending stamp tax disagreements that had developed between district courts.[32] The Florida Supreme Court agreed to address the question of whether the conveyance of property from a grantor to its wholly owned grantee was subject to the documentary stamp tax in *Crescent Miami Center, LLC v. Florida Department of Revenue*.[33] The facts of *Crescent* provide an example of a step transaction leading to the transfer of real property and the court's reasoning follows a step transaction analysis, unrestrained by the four corners of any particular document.

Crescent Equities – a real estate holding company - formed Crescent Miami Center, LLC, and then transferred 99.9 percent of its interest in Crescent Miami Center, LLC to a subsidiary limited partnership (Crescent Funding). The remaining 0.1 percent interest was transferred to the wholly owned Crescent Management. On the same day, Crescent Management transferred that 0.1 percent interest to Crescent Funding so that Crescent Funding became the sole owner of Crescent Miami Center. The next day, Crescent Equities transferred real property to Crescent Funding. The facts do not state that the property was subject to a mortgage.

The court found that the "transfer was made to separate the property from Crescent Equities' other assets in order to facilitate future unsecured financing.[34] The court ruled "that the transfer of property between a grantor and its wholly owned grantee, absent any exchange of value, is without consideration or a purchaser and thus not subject to the documentary stamp tax."[35]

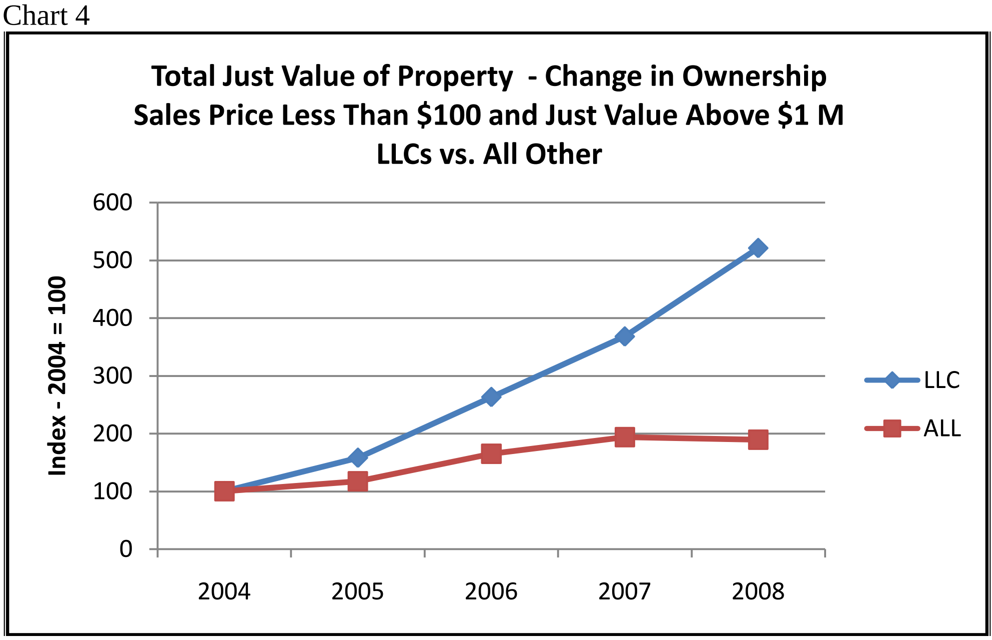
[30] A bankruptcy remote, special purpose entity, such as an LLC, can also play a role in funding the purchase of real property by reducing the risk of impairment to the collateral, increasing the assurance of preferred creditor status and by allowing for nonrecourse financing.
[31] John C. Connery, *Does a Cure Exist for Repeated Florida Documentary Stamp Taxes in Syndicated TIC Deals?,* The Florida Bar Tax Section Bulletin, Vol. XXIV, No.1, p. 15 (October, 2005).
[32] Compare, *Kuro, supra, with Crescent Miami Center, LLC, supra at* 857 So.2d 904 (Fla. 3rd DCA 2003); *see also, Muben-Lamar, L.P. v. Dep't. of Rev*., 763 So.2d 1209 (Fla. 1st DCA 2000).
[33] *Crescent Miami Center, LLC,* 903 So.2d at 913.
[34] *Id*. at 914.
[35] *Id*. at 919.

The opinion sanctions the transfer of unencumbered real estate into family limited partnerships for estate planning purposes. It also allows small businesses to limit risk by segregating assets into separate legal entities without paying stamp tax on the transfer.[36] However, *Crescent* also eliminates stamp tax when a single member LLC owning real property sells its membership interest to an unrelated party.[37] A deed may be recorded after a merger without payment of the tax. There may also be planning techniques available to avoid the tax imposed by subsection 201.02(1), F.S., on encumbered property as well.[38] Moreover, even if debt is assumed, the tax rate can be effectively reduced by more than half.[39]

The press has reported that the planning opportunity sanctioned by *Crescent Miami* is being used to transfer high value real property.[40] Charts 4 and 5 depict the just value (market value) of Florida real property transferred during the given calendar year. The just value of each parcel is established on January 1st of the year prior to the sale.

The "LLC" line in the Chart 4 represents the indexed just value associated with real estate transfers listing "LLC" in the property ownership line in the local property tax records. That record is also fixed on January 1. The LLC line is constrained to those transfers where stamp tax was paid in an amount less than $100 at the time of transfer. Chart 4 demonstrates that price constrained sales involving LLCs continue to show an overall increase in the aggregate just value associated with the property transferred, as distinguished from all other property transfers. The data does not specifically quantify the impact of *Crescent Miami*. The data captures ownership by an LLC on January 1. Residential property transfers would tend to be placed in private ownership by January 1, so that a homestead exemption could be claimed. But the frequency of LLC transfers involving a sales price of $100 or less and a just value greater than $1 million indicates the growing use of LLCs in tax planning.

Chart 4



In 2007, LLC transactions with just value greater than $1 million and a sales price of less than $100 rose by more than 400 percent from 2003, while all other LLC transactions rose by slightly less than 100 percent.

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[36] *See*, TAA No. 06B4-003 (5/11/2006).

[37] Vogelsang & Rappoport**,** *Crescent—Did the Florida Supreme Court Effectively Repeal the Documentary Stamp Tax on Transfers of Real Estate?*, The Florida Bar Journal, Volume 79, No. 9, p.44 (October, 2005); Connery, supra.

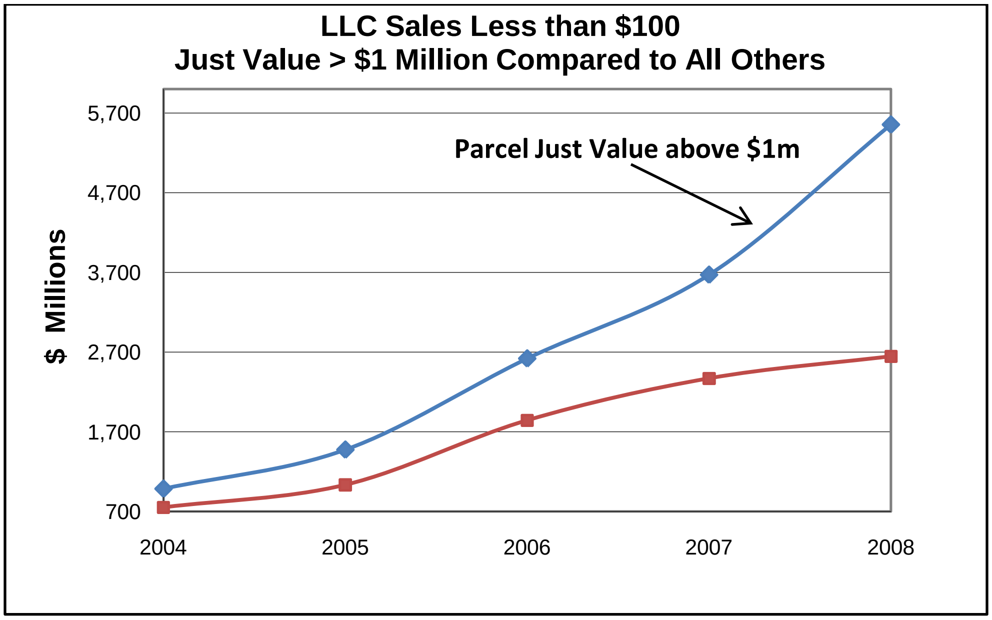
[38] *C.f.*, TAA No. 04M-001 (1/7/2004).

[39] *See*, TAA No. 06B4-010 (12/15/2006).

[40] Palm Beach Post, *Critics push to plug drain in tax loophole*, August 12, 2007.

For parcels with a just value exceeding $1 million, Chart 5 depicts the aggregate just value of parcels with a sale price equal to, or less than, $100, owned by LLCs on January 1 of the prior year. This aggregate just value is contrasted with LLC owned property with a sales price equal to, or less than, $100 and a parcel just value of less than or equal to $1 million. Transfers of properties showing minimal tax, but with just values greater than $1 million continue to increase in aggregate just value, as compared to all other LLC sales which have flattened by comparison.

Chart 5



The Reaction by Other States to the Use of These Planning Techniques

The original documentary stamp tax design remains adequate when applied to straightforward conveyances by deed. But it has not kept pace with current methods for transferring ownership of real property. Concerned that the use of planning techniques had lead to diminished revenue, several states have now imposed property transfer and recording taxes on transfers of a controlling interest in an entity that, directly or indirectly, owns real property. Most recently, Maryland, New Jersey and Washington have passed such laws.[41] A number of other states have similar laws.[42]

CS/CS/SB 2040 offered one potential solution to tax planning that was different from the approach offered by these other states. The bill authorized a person transferring unencumbered real property to a wholly owned legal entity to pay stamp tax by election either on the property's market value at the time of the transfer, or subsequently if there was a change in the ownership interest in the property or any ownership interest in the entity. The bill also permitted a subsequent tax free reversal of the original transaction.

This novel approach proved difficult to draft and raised concerns with tax practitioners. In hindsight, a clearer and more direct approach would have been to impose tax on the transfer of a majority ownership interest in a business entity. A transfer tax can be structured to give consideration to Florida's distinctive needs without differing dramatically from the consensus approach taken by other states.

The transfer tax has been integrated with some state's existing stamp tax statutes and has been enacted as a separate, parallel tax on non-deed transfers by others. Some states set a threshold value for the amount of

[41] Ann. Code of Md., Tax Property Art., sec. 12-117(c), 13-103(b); N.J. Stat. Ann., sec. 54:15C-1; Wash. Rev. Code, sec. 82.45.010.

[42] State imposing tax on the transfer of a controlling interest include Connecticut, Conn. Gen. Stat., Ch. 228b, sec. 12-638b; Delaware, 30 Del. Code, sec. 5401; Illinois, 35 I.L.C.S. 200/31-1 – 31-70; Maine, Me. Rev. Stat., Title 36, Part 7, Ch. 711-A, Sec 4641-A; New York, N.Y. Tax Law, sec. 1401; Pennsylvania, Penn. Title 72, Ch. 5, Art. XI-C, sec. 8101-C -8113-C.

consideration below which no tax is due. For example, New Jersey's tax is imposed on commercial properties if the total consideration for the transfer is greater than $1 million. A "controlling interest" is typically defined and often applies to transfers of more than 50 percent of the voting interest, capital, profits or beneficial interest of an entity. A "real property entity" may be defined in order to limit tax to transfers by entities that exist primarily to hold real property.

To be effective, a transfer tax must look through layers of ownership. When a lower level entity owns property, an examination limited to a parent will not disclose a transfer of ownership interest by the lower level entity to an unrelated party for consideration. A rule that aggregates a series of transfers of less than a controlling interest taking place over time is also necessary to prevent the effective passage of control without payment of transfer tax. Presumptions are generally used to connect a series of transactions over time, such as when people act in concert, or in accordance with a plan of transfer. The consideration paid for tax purposes can be the amount paid for an interest in the controlling entity or, when that amount cannot be determined, the market value of the real property transferred in proportion to the entity's ownership. Consideration usually includes the amount of any assumed debt. Returns are always required whenever there is a transfer of an interest in an entity that owns property, unless an instrument is recorded on the public records.

Exemptions from a transfer tax can be specified. The exemptions currently provided by section 201.02, F.S., can apply to controlling interest transfers when applicable. Other exemptions can also be added specific to a Florida transfer tax. Pennsylvania, for example, exempts transfers between members of the same family with an ownership interest in a real estate company, family farm corporation, or a family farm partnership that owns real estate.[43]

Connecticut, New York and other states exempt a "mere change" in identity, or form of ownership, as long as the interest that is transferred remains unchanged. A "mere change" may occur via merger among wholly owned subsidiaries and a Florida statute should determine which transfers between related parties can take place tax free. However, the "mere change" exemption should be subject to aggregation rules and should be combined with authorization to review the substance of a transaction, not merely the form. Such examination may be needed to determine whether there was a plan, or concerted action, to transfer the property to an unrelated entity. Viewing each individual step in isolation could otherwise result in the avoidance of tax liability.

Transfer taxes are not without problems. For instance, they require that a return be filed for every transfer. This creates an administrative burden that can be limited to some degree by setting reasonable reporting thresholds. Also, purchasers will require some way to be assured about their responsibility, or liability, for any prior transfers of a controlling interest. While working out the administrative details of a new tax regime would require time, especially for complex transactions, the experience of other states should be useful.

Findings

From 2005 to 2006, real estate sales fell by 25 percent in Florida overall, and property sales with a just value above $500,000 decreased by 15 percent. Bucking this trend, the aggregate just value of transferred parcels comprised of parcels with a just value above $500,000 and owned by LLCs, but with a recorded sales price of less than $100, was up 34 percent year-to-year. And, the aggregate just value of transferred parcels comprised of parcels with a just value above $1 million owned by LLCs on January 1, 2007, but with a recorded sales price of less than $100, was up 51 percent from 2007 to 2008.

Subsection 201.02(1), F.S., can be expected to continue to generate revenue for any given real property transfer to the extent that the tax expense is less than the additional expense associated with the tax planning activities. Concerns over marketable title and constraints imposed by lender requirements will provide some limitation on creative planning. But the economic incentive to avoid tax is significant. For the foreseeable future, current statutory provisions will continue to generate considerable tax revenue. However, data focusing on parcel transfers involving LLCs suggest that erosion of the tax base will continue and will accelerate for properties with a just value exceeding $500,000.

[43] Penn. Title 72, Ch. 5, Art. XI-C, sec. 8102-C.3 (20).

Recommendations

The application of formalized, standardized planning techniques currently allows for the tax free transfer of real property in Florida. Florida real property may currently be conveyed clearly and openly to an unrelated party for consideration without incurring documentary stamp tax liability. It has been argued that the absence of the stamp tax may – theoretically - spur some sales activity that would not otherwise occur. But this argument should be balanced with legitimate concern over the consequence of a failure of this pledged revenue source to meet outstanding obligations.

Legislation was proposed and passed by the Senate during the 2008 session to stem the use of planning techniques designed to avoid stamp tax. That legislation died in the Florida House without being heard. Unless legislation is passed, an increasing percentage of high value Florida real property conveyances will employ the available planning opportunities to avoid tax. Unchecked by statutory amendment, tax planning can be projected to progressively depress future stamp tax receipts. Therefore, legislation that protects this revenue source from continued erosion should be considered.