Florida Closes Documentary Stamp Tax Loophole

On June 10, Florida Governor Charlie Crist signed SB 2430 into law. Among other things, that bill amends Fla. Stat § 201.02 to close a loophole that had allowed taxpayers to avoid Florida’s documentary stamp tax on certain transfers of real property.

Current State of the Law

Pursuant to the Florida Supreme Court’s decision in Crescent Miami Center, LLC v. Florida Department of Revenue, 903 So. 2d 913 (Fla. 2005), transfers of unencumbered real property to wholly-owned subsidiaries “where nothing of value is exchanged” are not subject to Florida’s documentary stamp tax. That decision allowed taxpayers to use a planning technique, commonly known as a “drop and swap,” to avoid the Florida tax. In a “drop and swap” transaction, the seller of unencumbered real property would contribute the property to a wholly-owned subsidiary (typically either a single-member limited liability company or a corporation) and would then sell its ownership interest (i.e., LLC membership interest or corporate stock) in that subsidiary to the buyer. The contribution of the real property is not taxed under Crescent, and Florida’s documentary stamp tax is not imposed on the transfer of an ownership interest in an entity that owns real property since such a transfer is not considered a transfer of real property.

The Impact of SB 2430

Effective July 1, 2009, SB 2430 amends Fla. Stat. § 201.02 to prevent taxpayers from avoiding the documentary stamp tax by engaging in a “drop and swap” transaction. The amendments provide that, when real property is transferred without “full consideration” (i.e., consideration that would be paid in an arm’s length transaction between unrelated parties) to an entity in which the grantor owns a direct or indirect interest, the grantee becomes a “conduit entity.” If within three years of the conveyance to the conduit entity the grantor then transfers all or part of its direct or indirect interest in the conduit entity for consideration, the documentary

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1 If the property is encumbered by a mortgage, then the Crescent decision does not apply because the transfer is for consideration based on the assumption of the mortgage by the grantee and, therefore, documentary transfer tax will apply to the “drop” transfer.

2 Section 3, subsection (3) of SB 2430 specifically states that “it is the Legislature’s intent by this act to impose the documentary stamp tax when the beneficial ownership of real property is transferred to a new owner or owners by the use of techniques that apply the Supreme Court’s decision in Crescent in combination with transfers of ownership of, or distributions from, artificial entities.”

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The new law does not impose the documentary stamp tax on all transfers involving a conduit entity. The tax will not apply to a gift of an interest in a conduit entity, and it also does not apply to the transfer of an interest in a conduit entity by a natural person to an irrevocable grantor trust for estate planning purposes. In addition, transfers of ownership interests in a conduit entity that are traded on public, regulated security exchanges or markets are not subject to tax.

Furthermore, SB 2430 also forecloses the structure used by some property owners to avoid the tax where Florida real property is held in a land trust by first converting or merging the land trust into a corporation or limited liability company and then selling the interest in such a newly converted entity. The amendments to SB 2430 provide that the conversion or merger of a trust that is not a legal entity and that owns Florida real property into a legal entity (e.g., corporation, limited liability company, etc.) will be treated as a taxable conveyance of the Florida real property.

**Alston & Bird Comments**

While SB 2430 does change the tax treatment of these “drop and swap” transactions in Florida, the bill does not take effect until July 1, 2009, and will apply only to transfers for which the first transfer to a conduit entity occurs after July 1, 2009. Therefore, if a taxpayer transfers Florida real estate to a wholly-owned subsidiary on June 30, 2009, and then transfers the ownership interest in that subsidiary on July 2, 2009, the documentary stamp tax will not be imposed. Accordingly, taxpayers holding Florida real property should review immediately the way in which those properties are held, to determine if any properties should be transferred to wholly-owned subsidiaries prior to July 1, 2009. So long as such transfers are completed prior to that date, grantors may sell their ownership interests in such subsidiaries at any time without payment of the tax, since those subsidiaries do not qualify as conduit entities.

Finally, since SB 2430 only extends the application of the documentary stamp tax to cover the situation where an ownership interest is transferred in a conduit entity (within three years of the conveyance of real estate to such entity), prospective purchasers of Florida real estate from third parties should consider carefully their acquisition structure. For example, assume a taxpayer purchases Florida real estate and owns that real estate in its operating corporation with other real and tangible assets, and then later wants to sell just the Florida real property. Due to the new law, the taxpayer will likely be unable to structure the sale of that Florida property without payment of the tax. However, if the taxpayer had purchased the Florida real estate directly in a wholly-owned subsidiary of the operating corporation and that property was the subsidiary’s sole asset, the taxpayer could transfer its ownership interest in that subsidiary without payment of the tax because the subsidiary would not be a conduit entity.

*If you have any questions or would like additional information, please contact Jeff Glickman.*

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3 Transferring the beneficial interest in a land trust that owns Florida real estate is subject to the documentary stamp tax.
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