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Second Home in State Might Create Unforeseen Fla. Corporate Income Tax Obligations

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Many company executives enjoy spending time in their second homes in Florida. However, if they visit their winter home for an extended period (or just spend an extended time at a resort or timeshare), this might trigger a Florida corporate income tax obligation. This problem exists for closely held companies as well as public companies. This potential Florida tax problem is also a risk for corporate investors in private equity or hedge funds if managers of these funds maintain residences in Florida.

The reason for this potential problem is a Florida tax regulation stating that a corporation will be presumed to be doing business in Florida if a key officer resides in the state for three months in the aggregate within a 12-month period (Rule 12C-1.011(h) Fla. Admin. Code). If the company is doing business as a result of the presence of key officers in the state, this would require the corporation to file a Florida corporation income tax return. As a result, if a key officer visits his Florida home for three months or more during any 12-month

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period, the law will presume that the company is required to file a Florida income tax return, even if the company has no office or assets in the state.

The term "key officer" is not defined by the regulation. A 1996 private letter ruling from the Department of Revenue says that a key officer is one who "is so intrinsically involved in the running of the corporation or business, that their loss would be extremely detrimental to the corporation or business, and significantly impair its ability to conduct its business as it had previously." The ruling also states that if the company carries a key-person life insurance policy on an officer, then the officer would be considered a key officer. This definition would likely cover the chief executive officer, chief operating officer, chief financial officer and other "C-level" executives, or other officers who the company might insure with a key-person insurance policy.

The regulation also contains a presumption that management decisions are being made in Florida if the only officer or a key officer is residing in Florida. Most executives are tied to their smart phones and constantly checking business emails, texts, and calls. That data and the location of the phone can be accessed by state tax authorities to prove where management decisions are taking place.

This rule applies to closely held corporations as well as public companies. This could impact some closely held corporations that are used for estate planning or international tax planning purposes. In many cases involving international tax planning, little or no tax might be due, as Florida tax is based on federal taxable income. If a foreign corporation has little or no taxable income because of a tax treaty, the Florida tax impact would be minimal.

This rule might also be an issue for corporate investors in partnerships, including private equity or hedge funds classified as partnerships for federal income tax purposes. If a corporation is a partner in a fund or any other type of partnership in which a partner (including a fund manager) participates in management decisions and resides in the state for three months during the twelve-month period, the corporation would be required to file a Florida tax return (Rule 12C-1.011(v) Fla. Admin. Code).

It is important to note that this problem would not be an issue for most subchapter S corporations, because Florida's corporation income tax does not apply to a subchapter S corporation unless it has retained earnings from a period prior to making its subchapter S election.

It is also possible that the Florida tax obligation might be minimal, because income, for the most part, is apportioned based on the total sales in Florida in proportion to total sales. However, for a closely held corporation with significant labor costs, the amount of Florida tax could be material if the key officer in Florida is paid a salary by the company. The potential tax ramifications would need to be reviewed by the company's tax return preparer.

The potential exposure can be much greater if the corporation has substantial income from intangibles, such as dividends, interest, or royalties. This is because income from intangibles is allocated to a corporation's "commercial domicile." This is generally deemed to be the company's headquarters. If a corporation does not have an identifiable headquarters because it holds primarily intangible assets, and key officers reside or spend a substantial amount of time in Florida, the Department of Revenue might take the position that the company's commercial domicile is located in Florida, and that all of its income from its intangible assets is subject to Florida income tax.

The most substantial risk would be faced by corporations that hold passive investment assets which are not presently subject to income tax in any other state (for example, a corporation organized in a state with no corporate income tax on passive investment assets like Nevada, Wyoming or South Dakota). If a key officer

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resides in Florida for more than three months, this would trigger a Florida tax obligation when no other state income tax obligation might otherwise exist. This could impact tax planning structures for wealthy families, or intellectual property holding companies set up in a state which does not tax income from IP royalties.

This rule would not have an impact if the company otherwise has a physical presence in Florida, by virtue of other employees being present in the state, or because the company owns or leases assets in the state. In such a case, the company would already have a nexus to the Sunshine State, and would be obligated to file a Florida income tax return whether or not a key officer resides in the state.

If a corporation has potential Florida income tax exposure because an officer has a home in the Sunshine State, the risk can be reduced if the officer can prove that he was not present in Florida for three out of twelve months. It is important to count the total number of days in Florida, not merely the days spent in the home. For example, if an executive owns a residence in Miami Beach and also spends two weeks at golf resorts around the state, those additional two weeks must be counted. Evidence of absence from Florida can be shown by a calendar diary, air tickets, or credit card receipts showing purchases made in another state, preferably on a daily basis, even if it is just a purchase for a daily cappuccino at a coffee retailer.

For a closely held company, one possible remedial action might be for the key officer to resign as an officer, and simply continue on as a director or the sole director of company. As a director, this person would still be able to maintain control over the company by appointing others to serve as the key officer.

For a company which owns material intangible assets, steps should be taken to prove that the company's commercial domicile is located in a state other than Florida, so that the income from the intangibles would not be allocated to Florida, but rather, to a state that does not impose an income tax on income from intangibles. Such steps would include leasing an office, having a phone and mailing address, hiring an employee to answer the phone, all in the tax friendly state. There are corporation service companies that provide all these services for a fee.

This regulation has the potential to cause unforeseen Florida income tax problems when officers own second homes in Florida, or have extended stays at resorts or timeshares. With proper planning, the potential Florida tax risk can be managed. There is also the possibility that this regulation could be repealed legislatively if a law is passed to limit this very broad regulation. After all, it might be considered poor economic development policy to scare corporate executives away from owning a home in Florida.

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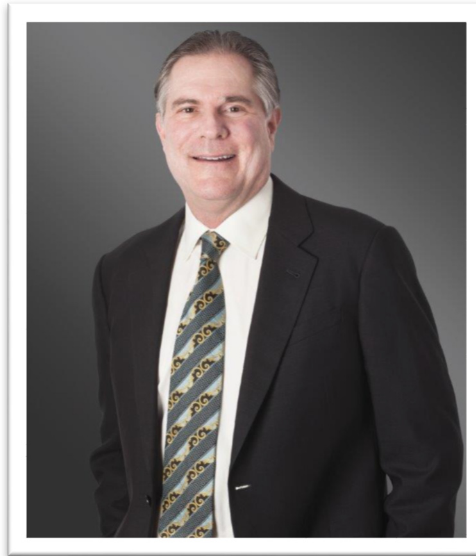

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