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by Marvin A. Kirsner

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Marvin A. Kirsner is a shareholder in Greenberg Traurig's Fort Lauderdale, Florida, office, where his primary areas of practice deal with corporate, transactional, and industry-specific tax issues. He serves as the co-chair of the state and local tax practice.

In this article, Kirsner explores a recent Florida appellate case that is expected to have significant tax consequences for conveyances of real property to controlled entities, potentially resulting in increased property taxes for many internal reorganizations and estate planning transactions.

Under Florida tax rules, real property that does not have a homestead exemption is entitled to a 10 percent cap on annual increases in its assessed value for real property tax purposes.[1] The cap generally will remain in place unless there's a change in ownership or control, or a qualifying improvement to the property, among other exceptions. Because of dramatic increases in property values over the past several years, the 10 percent cap statutes have resulted in major tax savings for many Florida property owners.

A Florida appellate case[2] decided in 2023 held that the conveyance of real property to a limited liability company controlled by the grantors resulted in a reassessment of fair market value for real property tax purposes. The Florida Supreme Court recently denied discretionary review, and this decision is final.[3] The case, *S and A Property*, could have a material impact on real property taxes for a wide array of related-party real estate conveyances, including internal restructurings of real estate holdings, admission of new investors, and estate planning transactions. Accordingly, the ramifications of *S and A Property* should be analyzed when planning internal corporate restructuring transactions in which deeds will be recorded. This same caution would be applicable to estate planning transactions.

The 10 Percent Cap on Annual Increases in Taxable Value

Florida's constitution was amended in 2008[4] to impose a 10 percent annual cap on increases in taxable value of non-homestead real

[1] Fla. Stat. Ann. sections 193.1554 (for non-homestead residential properties of nine units or less), 193.1555 (for all other non-homestead property).

[2] *S and A Property Investment Services LLC v. Pedro J. Garcia*, 360 So.3d 432 (Fla. Dist. Ct. App. 2023).

[3] Case No. SC2023-0796 (petition for review denied Oct. 24, 2023).

[4] Fla. Const. Article VII, section 4(g) and (h). This 10 percent annual cap does not apply to the county school district's tax millage, so the school district's share of taxes is not limited by this rule. Section 4(g) applies to non-homestead residential property of nine units or less, and section 4(h) applies to all other non-homestead real property.

property.[5] This cap is lifted when there is a change of ownership or control, resulting in a reassessment to FMV (from the county property appraiser's perspective). The enabling statutes[6] enacted in connection with this constitutional amendment define a change of ownership or control as:

> any sale, foreclosure, transfer of legal title or beneficial title in equity to any person, or the cumulative transfer of control or of more than 50 percent of the ownership of the legal entity that owned the property when it was most recently assessed at just value.[7]

This reassessment provision generally has not been widely known in the real estate industry until recent years. The 10 percent annual cap came into being during the Great Recession when real property values were plunging — not increasing at a greater than 10 percent annual rate. Now that real property values are increasing dramatically in some Florida markets, the cap could become a significant concern for many related-party and estate planning transactions involving conveyances of real property.

S and A Property

Although *S and A Property* is now binding precedent, there is hope that another district court of appeals might arrive at a different conclusion if it explores a line of property tax cases regarding the beneficial ownership of real property. To understand this alternative legal argument, we must dive deeper into the court's decision in the case.

In *S and A Property*, a husband and wife conveyed real property that they owned as tenants by the entireties to an LLC. The LLC was owned 51 percent by the wife and 49 percent by the husband. The county property appraiser lifted the 10 percent cap on annual increases in taxable value for 2021, resulting in a reassessment and a material increase in property taxes. The LLC filed a legal action in circuit court to challenge the lifting of the 10 percent cap. The circuit court ruled for the property appraiser, and the LLC appealed to the district court of appeals.

On appeal, the LLC argued that this conveyance was not a change in ownership because the statute provides an exception for conveyances between legal and equitable title.[8] The precedent cited for this argument was a 2005 Florida Supreme Court case[9] that held that the transfer of unencumbered real property to a 100-percent-owned entity was not a transfer for documentary stamp tax purposes. The court held that there was not a change in ownership because the same person was the beneficial owner of the property both before and after the conveyance.

The *S and A Property* court rejected the taxpayer's argument and affirmed the lower court, finding that the earlier supreme court case was not applicable precedent because it involved a documentary stamp tax issue[10] and was not relevant to this real property tax controversy.

S and A Property has created a potential trap for real property owners who might be under the impression that real property can be contributed to a controlled entity without property tax consequences. *S and A Property* did not involve a transfer to a 100-percent-owned entity (because the LLC membership interests were owned separately by the husband and wife, not as tenants by the entireties as the real property was held). However, under the court's rationale, *S and A Property* would also apply to a conveyance to a 100-percent-owned LLC even though the LLC would be a disregarded

[5] This increase in taxable value limitation rule for non-homestead property is similar to, but less generous than, the 3 percent cap on increases in value of Florida homestead property. The 3 percent cap on homestead property has been in effect since 1994 and has resulted in huge gaps between taxable value and FMV of many primary residences for real property tax purposes. Since the 10 percent cap law on non-homestead property has been in effect only since 2009, and the cap is much higher than the 3 percent cap for homestead property, the gap between fair market and taxable value for non-homestead properties is typically not as significant and does not make much of a difference in many real estate markets where increases in FMV average less than 10 percent. However, there are some overheated real estate markets in Florida where this 10 percent cap has resulted in significant tax savings, making *S and A Property* an important consideration when planning estate planning transfers, internal corporate transactions, or the admission of new investors into the ownership of Florida real property.

[6] *Supra* note 1.

[7] Fla. Stat. sections 193.1554(5) and 193.1555(5).

[8] Fla. Stat. Ann. section 193.1554(5)(c).

[9] *Crescent Miami Center LLC v. Department of Revenue*, 903 So.2d 913 (Fla. 2005).

[10] *S and A Property* states that *Crescent Miami Center* was not relevant because the documentary stamp tax statute involves the sale of property, not the mere conveyance of property to a controlled entity. However, both cases clearly involve a transfer of property to a controlled entity.

entity for income tax purposes.[11] As a result, this ruling has far-reaching effect. It would apply to:

- individuals or companies seeking to transfer real property to an LLC for liability protection reasons (as was the case with *S and A Property*);
- individuals placing property into an LLC or limited partnership for estate planning purposes;
- companies undergoing internal reorganizations; and
- a multitude of other situations.

Arguments for a New Case

As noted above, the *S and A Property* court rejected the taxpayer's argument that the conveyance was between legal and equitable title and the property owner's reliance on the documentary stamp tax case. However, the opinion did not explore real property tax cases involving the question of which party is the equitable owner of real property, even though title is held by another.

In the 2015 decision in *Russell v. Southeast Housing LLC*,[12] Florida's Third District Court of Appeals considered whether property owned by an LLC that was a joint venture between the U.S. Navy and a housing developer was exempt from real property taxation. In that case, the Navy conveyed property to Southeast Housing LLC (the J.V. Entity), a for-profit joint venture owned by the Navy and housing developer. The J.V. Entity then developed the property into housing for Navy personnel. The project was leased by the J.V. Entity to the Navy under a 50-year lease. The Monroe County property appraiser assessed the housing facility as taxable property because it was no longer owned by the Navy, and therefore — according to the property appraiser — was no longer exempt from taxation as government-owned property.

The court found that the Navy, as the lessee of the housing project, was the equitable owner of the property even though the Navy had conveyed the property to the J.V. Entity, and therefore the project was not subject to taxation. The court came to its conclusion by reviewing the level of control that the Navy retained over the housing project under the J.V. Entity's operating agreement.[13] The court found that the rights to control the property retained by the Navy made it the equitable owner of the property — even though title was held by the for-profit J.V. Entity.

If a new case with facts similar to *S and A Property* is brought in a circuit court where an appeal would be made to a different appellate court than the one that decided *S and A Property*, *Southeast Housing* could be the applicable precedent. In this case, it would be logical for the court to conclude that if a person conveys real property to a controlled legal entity and continues to control all aspects of the real property through their control of the legal entity, then they remain the beneficial owner of the real property for real property tax purposes. Accordingly, an appellate court could reasonably conclude that this conveyance is a transfer between legal and equitable title and therefore is an exception to the change of ownership rule, so the 10 percent annual cap on increases in taxable value would not be lifted.

Related-Party Transfers of Entities

The 10 percent cap would also be lifted in the event of a change of control of an entity that owns Florida real property.[14] It is possible that some county property appraisers might interpret *S and A Property* to apply to an internal transfer of an entity that owns real property to an affiliated company.

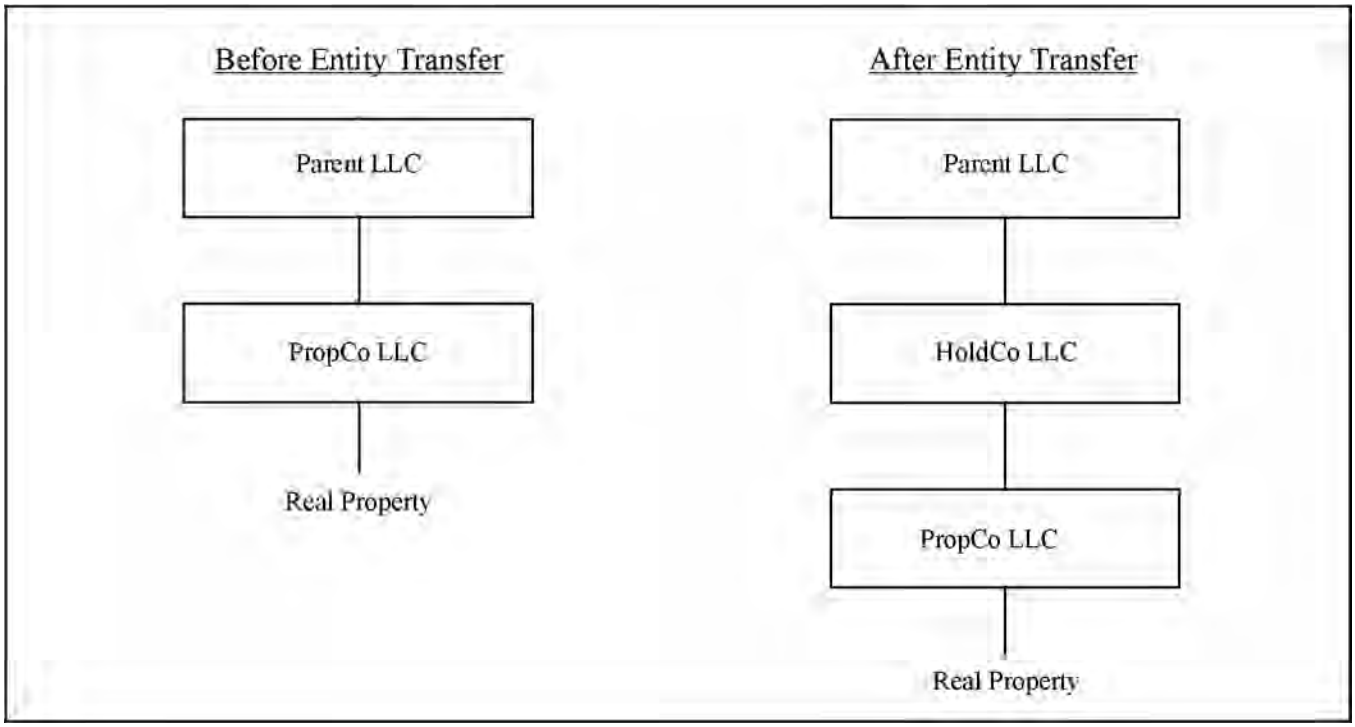
Let's consider, for example, a financing transaction in which the lender requires the borrower to insert a new separate holding company (HoldCo) between the parent company (Parent) and the entity that holds title to the real property (PropCo), and both PropCo and HoldCo are single-member LLCs that are disregarded entities for federal income tax purposes:

[11] A single-member LLC that is disregarded for federal income tax and Florida corporate income tax purposes is treated as a separate legal entity for all other Florida tax purposes. Fla. Stat. section 605.1103(3). Consequently, if real property is conveyed to a 100-percent-owned LLC, it would be treated as a conveyance to a separate legal entity for Florida real property tax purposes, just as the grantors in *S and A Property* conveyed to a separate legal entity.

[12] *Russell v. Southeast Housing LLC*, 162 So.3d 262 (Fla. Dist. Ct. App. 2015).

[13] The Navy retained several important rights over the real property it had conveyed to the J.V. Entity, including the right to (1) determine and enforce the plans and specifications of the housing project; (2) appoint the head of construction for the project; (3) control the tenants allowed to rent in the project and the rents charged to the tenants; (4) approve the form of the leases; (5) terminate the supervision of the project; (6) control access to the property; (7) supervise operations of the housing project; (8) the lion's share of the profits and right to control the income generated from the housing project; and (9) ownership of the improvements at the end of the lease term.

[14] Fla. Stat. Ann. sections 193.1554(5) and 193.1555(5).



The 10 percent cap statutes define a change of control as: "the cumulative transfer of control or of more than 50 percent of the ownership of the legal entity that owned the property."[15] This would appear to include an internal transfer of all the membership interests of PropCo from Parent to HoldCo in our example.

However, under regulations,[16] this internal transfer of PropCo to HoldCo should not result in a change of control because of an additional requirement: that the "controlling ownership rights" — the right to control the property-owning entity (PropCo LLC in this example) — must also change for there to be a change of control.[17]

Since Parent LLC would continue to own the controlling ownership rights in PropCo through its ownership of HoldCo, it would appear there has been no change in the controlling ownership rights of PropCo. Parent LLC still retains the controlling ownership rights of PropCo by virtue of its ownership of HoldCo.

However, under the holding of *S and A Property*, a county property appraiser might assert that this transaction would be a change of control because HoldCo is a separate legal entity, and therefore, the controlling ownership rights have been transferred.[18] By contrast, the regulation provides for a look-through of the ownership of controlling ownership rights when dealing with single-member LLCs, which are disregarded entities for income tax purposes, by defining the term "controlling ownership rights" to also include "an ownership interest in property owned by a limited liability company or limited partnership that is treated as owned by its sole member or sole general partner."[19]

In our example, since Parent LLC is the sole member of HoldCo, and HoldCo is the sole

[15] *Id.*

[16] Fla. Admin. Code. r. 12D-8.00659 (4)(a)1.

[17] Defined as: "the voting capital stock or other ownership interest that legally carries voting rights or the right to participate in management and control of the legal entity's activities." Fla. Admin. Code r. 120-8.00659(3).

[18] Under the regulation, for a change of control to occur, there must be a change of ownership in the real-property-owning company (PropCo) and either (1) an owner who did not own more than 50 percent of the controlling ownership rights becomes an owner of more than 50 percent of the controlling ownership rights or (2) an owner who owned more than 50 percent of the controlling ownership rights becomes the owner of less than 50 percent of the controlling ownership rights. Fla. Admin. Code. r. 12D-8.00659(4)(a)1.

[19] *Id.*

member of PropCo, then under this regulation, Parent LLC should still be treated as the owner of PropCo. Thus, there has been no change in the controlling ownership rights of PropCo, and hence, no change of control would occur because of this internal restructuring. Despite this regulation, there is still a chance that this conclusion might be challenged by a county property appraiser.[20]

If there is a change of control in a legal entity that owns Florida real property, the county property appraiser must be notified through the filing of a Florida Department of Revenue Form DR-430.[21] The failure to file the Form DR-430 if there has been a change in control could result in a rather draconian penalty — any tax savings that resulted from the property appraiser not lifting the 10 percent cap must be paid (with a 10-year lookback period) plus interest at 15 percent, and a penalty of 50 percent of the taxes saved.[22] In the case of an internal corporate transfer of an entity that owns real property (such as in the scenario above), a question arises whether to notify the county property appraiser.[23] The most cautious approach would be to file a Form DR-430, including a statement that the transfer does not result in a change of control (with an explanation of why), and reserve the right to challenge a reassessment in the courts if the property appraiser disagrees.

Assessing the Consequences of a Change of Ownership or Control

It is important to remember that a change of ownership or control might not make a difference unless the property has been appreciating at a rate of greater than 10 percent annually. However, in hot real estate markets with 10-percent-plus annual appreciation rates, the impact can be significant.[24] When planning a transaction that involves conveying real property to a controlled entity, the property tax records should be reviewed to determine whether there is a gap between the FMV (from the county property appraiser's perspective) and the assessed or taxable value (the amount on which the tax is calculated). It is not uncommon to see wide differences between the FMV and taxable value in rapidly appreciating markets. In that case, a tax impact of the conveyance would be certain — since the change of ownership would lift the 10 percent annual cap on increases in taxable value for the year following the conveyance.

Further, even in a situation in which there is not a significant gap between the FMV and the taxable value, it is possible that the property could appreciate significantly more than 10 percent the following year, when reassessment would occur. For example, assume the property is conveyed to a controlled LLC in December 2024, when the FMV and taxable value for 2024 (according to the county property appraiser) are the same. The 10 percent cap would be lifted for the 2025 tax year, and there is a chance of a major leap in the FMV greater than 10 percent, which would result in a more expensive property tax bill for 2025 than there would have been but for the 2024 conveyance. Although the potential increase in value for the following tax year is an unknown here, advice from a qualified appraiser should be able to give some idea of the potential for a greater than 10 percent increase in value for the following tax year.

If structuring a transaction that will involve a post-closing conveyance of Florida real property to a controlled entity after the purchase of the property, the timing of the post-closing transfer

[20]There is the possibility that a county property appraiser might challenge the validity of this regulation, because it treats a single-member LLC as a disregarded entity, and not a separate legal entity, as required by the Florida LLC statute (see Fla. Stat. Ann. section 605.1103(3), which states that a single-member LLC is treated as a disregarded entity only for Florida corporate income tax purposes, but will be treated as a separate legal entity for all other purposes). This could allow a county property appraiser to argue that the regulation is invalid because it conflicts with a Florida statute. However, a court might look to the Florida Constitution, which states that to lift the 10 percent annual cap on increases in the assessed value of real property, there must be a change in control of the entity that owns the real property, and find that Parent's control of PropCo has not changed as a result of this internal reorganization under the plain meaning of the words "change in control," and conclude that the regulation is valid since it properly interprets the intent of the constitution.

[21]Fla. Stat. Ann. section 193.1556(1). However, this notice is not required to be filed when a change of ownership occurs as the result of a deed being recorded.

[22]*Id.*

[23]Informal discussions with the legal staff in a county property appraiser's office revealed that it is their position that the above scenario would require a Form DR-430 to be filed.

[24]There are some properties in south Florida where the gap between the FMV (from the county property appraiser's perspective) and the taxable value exceeds $50 million because of the 10 percent cap.

could be critical. If the post-closing conveyance to the controlled entity occurs in the same year the property was acquired, the post-closing transaction would not make a difference since the 10 percent cap would already have been lifted because of the acquisition earlier in the year. On the other hand, if the post-closing transfer to a controlled entity occurs in the next calendar year, the 10 percent cap would be lifted once again for the year following the transfer.

For example, assume an investor acquires a warehouse project in June 2024. The 10 percent cap will be lifted for the following year. If the investor then engages in a post-closing transaction in December 2024 to bring additional investors into the deal, this post-closing transfer would not make a difference, since the 10 percent cap has already been lifted for 2025 because of the June 2024 acquisition. On the other hand, if the post-closing transaction does not occur until January 2025, the 10 percent cap will again be lifted for the 2026 property tax year. It makes little sense from a property tax perspective to lift the 10 percent cap two years in a row if the post-closing transaction can occur in the same calendar year of the initial acquisition.

Conclusion

There are a few potential fixes to the problem created by *S and A Property*. The quickest fix would be for the Florida Legislature to amend the statutes to state that a deed to a controlled entity is treated as a conveyance between legal and equitable title. The other fix would be the judicial route — to bring a test case in a county in which an appeal would not go to the Third District Court of Appeals. Another appellate court might find that a deed to a controlled entity is a transfer between legal and equitable title based on *Southeast Housing*, and therefore is not a change of ownership. The Florida Supreme Court would then (hopefully) agree to review the case based on a conflict between the two district courts of appeal, and (hopefully) hold that this transfer fits within the exception for transfers between legal and equitable title. Such a judicial route would likely take several years, and the outcome would not be certain. The legislative route would be much faster and more certain.

Until the decision in *S and A Property* is reversed, either legislatively or by the Florida Supreme Court, the risks of a conveyance of real property to a controlled entity, or of an internal entity transaction or reorganization, should be carefully analyzed. ■