Research Report

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Changes to Intangibles and Doc Stamp Tax Treatment of Credit Transactions Will Benefit Taxpayers, Consumers and Lenders

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The 1996 Florida Legislature passed a law that would extend the intangibles tax treatment of home equity lines of credit secured by a borrower's primary residence to lines secured by a borrower's other residence. This law would have a positive impact on both borrowers and lenders, be easier for the Department of Revenue to administer and positively impact the state's revenue collections.

Unfortunately, this provision was included in Committee Substitute for Senate Bill 624 -- the so-called "tax train." This large piece of legislation was one of the last bills passed and was subsequently vetoed by the Governor.

The intangibles tax provision surely would have survived if it would have stood on its own. Florida TaxWatch released a report recommending this law change in April 1995. Legislation was filed in the 1996 session and the issue worked its way through various committees. While other bills containing this provision passed either the House or the Senate, only CS\SB 624 passed both houses.

The veto of CS\SB 624 does not negate the fact that this is something the state should do. New legislation (SB 648 and HB 1337) has been introduced this session that not only includes this change, but also makes some beneficial changes to the documentary stamp tax treatment of credit transactions.

Background - Intangibles Tax Treatment of Home Equity Lines of Credit

Currently, the state's intangibles tax (2 mills) is levied on home equity lines of credit secured by primary residences one time -- on the total amount of the line. This is done up-front, at the time the line is opened. Lines secured by a residence other than the borrower's primary one are subject to the intangibles tax each time the line is accessed.

In most cases a borrower who opens a home equity line of credit is given a book of checks that can be used to access the line of credit. The borrower can use the checks at any time for any purpose, providing the available credit is not exceeded. For lines of credit secured by the borrower's primary residence this is not a problem--the total intangibles tax liability has already been settled. However, for lines of credit secured by other types of residences that have tax due each time a check is written, this obviously creates some administrative difficulty for lenders.

This difficulty means most lenders do not write lines of credit on non-primary residences. Representatives from three of Florida's major banks who have over one-third of the state's banking market report to Florida TaxWatch that because of the way the law is applied, their banks would not knowingly write a line of credit on other types of residences. These banks also report that a significant market for home equity lines of credit exists for these types of residences:

1) Second homes;
2) Homes owned by foreign nationals; and
3) Homes held in living trusts.

In 1985, when the state first began levying the intangibles tax on all home equity lines of credit each time an advance was made, the problems this created for lenders quickly became clear. With numerous checks being written on a line of credit -- many for small amounts -- it was difficult to keep track of the tax due and remit the tax within 30 days of each advance. Due to these compliance problems and the fact that lenders were exposed to penalties and interest even when acting in good faith, the 1986 Legislature enacted statutory language allowing for the one- time, up-front taxation of a line of credit when it is secured by a residence of the borrower.

The current problem stems from the term "a residence of the borrower" in the *Florida Statutes* (s. 199.143 (3)). The Department of Revenue's intangibles tax rules define residence as being synonymous with domicile: "where a person has his true, fixed and permanent home and principal established, and to which when absent, he has the intention of returning." This definition of residence, applied to the current statute, precludes home equity lines of credit on all dwellings except an owner's primary home from having the intangibles tax applied one-time, up-front on the entire amount of the line of credit.

The problems addressed by the Legislature in 1986 still exist today for lines of credit secured by non-primary types of residences. Florida lenders report that the costs and difficulties in tracking, collecting, reporting and remitting the tax are prohibitive. These costs, along with the potential for penalties and interest remove the incentive to conduct business in this area. These types of equity lines are also discouraged from a consumer standpoint. The amount of customer interaction required reduces one of the most attractive features of home equity lines -- hassle-free credit.

Another concern is that lenders do not have the ability to police what customers do with their property once an equity line is established. People may get married or divorced, experience a death in the family, move into a new homestead and rent out their original property or use it as a vacation home. Elderly people may put title to their homestead into a trust so that, technically, they are not the owner. If all residential lines were taxed equally, there would be no fear that lenders would inadvertently violate the law because of lifestyle changes made by their customers.

Expanding the intangibles tax treatment of home equity lines of credit on primary residences to lines secured by other types of residences has several benefits: Citizens will get an added, attractive credit option, lenders will have a relatively untapped market opened to them and our state's tax policy will become a little less complicated. The change will also result in increased state tax revenues through increased lending (see below.) This will also bring Florida's definition of "residence" closer to the federal definition used for income tax deductibility of interest.

Documentary Stamp Tax Provisions

There have been numerous changes in recent years in the way Florida applies documentary stamp taxes to notes and mortgages. The result of these changes is that credit transactions have become complex and burdensome. This increases the cost of credit transactions and exposes lenders to significant risks for inadvertent noncompliance. Following is a summary of changes to help this situation that are contained in SB 648 and HB 1337:

Renewals. Minor changes to note or mortgage documents are considered renewals. All renewals are potentially taxable regardless of the nature of the change or whether the original note or mortgage was taxable. In order to avoid paying additional doc stamp taxes, a lender must structure its renewal transactions to meet three statutory exemption requirements -- or when no mortgage is involved -- take the document out of state. Structuring modifications to make sure tax is not due is a complicated task. The proposed legislation would define the term "renewal" as only those changes which modify the underlying obligation by adding new money, adding obligers or changing the interest rate, maturity date or payment terms. Only these type of renewals would be taxable.

"Four-corners test." Taxability of a document has historically been determined by the face of that single document. A 1995 court decision ruled that multiple documents can be read together to form a single taxable document. This can result in unintended compliance problems, inadvertent payment of tax on the wrong document and the imposition of tax on multiple documents. The proposed legislation would return the state to its pre-1995 tax treatment by stipulating that tax is only paid once when multiple documents form the same primary debt.

Multiple Taxation. The legislation would eliminate the possibility that a single transaction would be taxed multiple times because of the way collateral is structured. For example, under current law if a Florida company executes a note and the owner of the company takes out a mortgage on his house to secure the loan, both the note and the mortgage are taxable even though there is only one loan. Multiple taxation can also occur when related borrowers cross-collateralize or cross-guaranty mortgage loans. The legislation makes it clear that documents that secure a note, secure that primary obligation and not a separate one.

Renewals of revolving lines of credit. Under current law, a renewal note is exempted from taxation if it is executed by the same obligers and does not increase the current principal balance. However, since a revolving line of credit has a changing balance, rarely is it fully funded at renewal. So, it is the current practice of lenders to "fund up" the line to its original principal amount immediately prior to renewal, then require repayment of the amount funded. The legislation would exempt the renewal of a revolving obligation if it renews the original face amount of the obligation.

Correction of payment errors. If the tax on a document is miscalculated and underpaid when the document is renewed, the renewal is fully taxable. The bill would allow for correction of such errors through payment of the tax, interest and penalty on the earlier document.

These five issues increase the complexity of credit transactions, thereby increasing costs and exposing lenders to inadvertent errors. Taxation in many of these instances can be avoided by taking the proper steps. This just requires lenders to spend more time and resources to comply with the law. This also can result in some taxpayers paying more tax on a similar transaction than other taxpayers only because they are unaware or unsure of the proper steps to take.

Intangibles Tax Change Would Result in Added State Revenues

The Consensus Estimating Conference has put a positive fiscal impact on changing the intangibles tax treatment of home equity lines of credit. It estimates the law change will bring in approximately $1.8 million in added intangibles and documentary stamp taxes in FY 1997-98.

This estimate is conservative. It must be noted that the banking industry sees a large unsatisfied demand for the very popular home equity lines of credit on non-primary residences and is certain that the net amount of loans written in Florida would increase significantly. Home equity lines tend to be large -- the ones issued by the three banks surveyed by Florida TaxWatch averaged $32,000. It should also be remembered that the tax would be paid on the maximum amount of the line, even if it is never used or is only partially used. Approximately 30% of the lines issued by these banks are not currently opened. Further, some people who might not even qualify for certain types of retail credit (which is unsecured) could qualify for an equity line because it is secured. Also, since equity lines have lower interest rates and provide a federal income tax deduction, some borrowers who might not be able to afford other types of credit might be able to take out a home equity line of credit.

In addition to this direct increased revenue, potential, indirect tax benefits also exist such as the franchise tax on corporate profits enjoyed by lenders as a result of additional lending capacity and sales tax derived from consumers with borrowing power that is not available to them today.

The documentary stamp provision will have a small negative fiscal impact. This is minimized because in many circumstances, as discussed earlier, lenders often legally avoid the tax. The Consensus Estimating Conference projects approximately $3.3 million in reduced doc stamp and intangibles taxes resulting from these provisions in FY 1997-98. Coupled with $1.8 million positive fiscal impact of the intangibles tax change, the total negative fiscal impact of the bill in FY 1997-98 is estimated at $1.5 million. However, TaxWatch contends that the positive impact of the intangibles tax change is conservative and could potentially offset the loss from the doc stamp provisions.

This report was researched and written by Kurt Wenner, Senior Research Analyst, under the direction of Dr. Neil S. Crispo, Senior Vice President, Research and Operations.
