

REAL ESTATE ALERT

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Abandonment of Leasehold Interest May Result in Sales Tax Liability to the Landlord

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The current downturn in the real estate industry has begun to affect the commercial property arena as retail and other commercial tenants have been experiencing significant loss of sales revenue. While the loss of rental income is problem enough, a landlord unaware of the risks may find itself liable for the tenant's unpaid sales tax.

If a tenant that defaults under a written lease is a retailer (dealer) under F.S. Chapter 212, F.S.A., and that tenant owes unpaid sales tax to the Florida Department of Revenue ("Department"), the landlord needs to exercise caution if the tenant abandons the demised premises leaving the tenant's inventory or operating equipment. This is especially true if the lease contains an abandonment clause which vests title to the tenant's inventory or operating equipment in the landlord. The reason for this is that the Department may assert that the tenant has, in essence, "sold" its business to the landlord, in which case the landlord may become personally liable for any delinquent sales taxes owed by the tenant pursuant to Section 212.10(1), F.S.A.

Under Section 212.10(1), F.S.A., the purchaser (or other successor) of a business or its inventory will become personally liable for the seller's unpaid sales and use tax liability (including interest and penalties) unless the purchaser takes certain steps to ensure that the seller has no such unpaid

sales or use tax liability. These steps include getting a written statement from the Department showing that there are no delinquent sales and use taxes owed by the seller (including interest and penalties) or, if there are delinquent sales or use taxes owed by the seller (including interest and penalties), the purchaser is required to withhold a portion of the purchase price sufficient to pay these delinquent taxes, interest and penalties owed. The purchaser's (or, in this case, the landlord's) failure to comply with these requirements may result in personal liability to the purchaser (or landlord) under Section 212.10(1), F.S.A. In addition, such failure to comply with these requirements may also constitute a first degree misdemeanor pursuant to Section 212.10(5).

In a case of first impression, the Fourth District Court of Appeal of Florida in *Robert H. Jacobs v. Claude Kirk*, 223 So. 2d 795 (4th DCA 1969), was faced with exactly this situation. In that case, the tenant abandoned the demised premises and left its entire inventory behind. The landlord claimed (and the trial court agreed) that title to the inventory had passed to the landlord pursuant to an abandonment clause in the lease. The Court of Appeal held that the landlord who claims the benefit of such a lease provision (i.e., ownership of the inventory) should also be expected to bear the "burden"

of such acquisition. The Court noted that the transfer of the inventory from the tenant to the landlord amounted to a "sale" of the inventory within the meaning of Section 212.10(1), F.S.A., and since the landlord failed to comply with the requirements of that Section, the landlord (as purchaser) became personally liable for the payment of delinquent sales and use taxes (including interest and penalties) owed by the tenant.

The holding in this case is consistent with current provisions of the Florida Administrative Code which state that a business is deemed to have been "sold-out" if a tenant abandons his business owing his landlord rent and the landlord, acting under an abandonment clause in the lease, takes ownership of tangible personal property left on the premises by the tenant. FAC Rule 12A-1.055(3)(a)3.

Accordingly, in light of the *Kirk* case and the above-referenced FAC Rule, a landlord faced with a similar situation should be cognizant of the potential personal liability for the tenant's delinquent sale and use taxes (including interest and penalties) in the event that the tenant abandons its leasehold interest and the title to the tenant's business assets passes to the landlord under the terms of the lease. A landlord in that lease situation

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must be even more cautious than a typical business purchaser since there is no "purchase price" from which to withhold the unpaid taxes. A landlord suffering the loss of a tenant and the concomitant rental stream would not want to also find itself having to pay out-of-pocket for sales and use taxes owed by its defunct tenant (including interest and penalties), nor would the landlord wish to find itself subject to a potential second degree misdemeanor charge.

Because the nature of the abandoned property and the terms of each lease can vary greatly, each such situation involving the abandonment of a tenant's leasehold interest should be carefully analyzed to determine if the trade-off between the value of the tenant's abandoned property and the landlord's potential exposure for the tenant's unpaid sales tax risk is worthwhile. Each such landlord should consult with its own legal and tax advisors to determine the appropriate action to be taken by the landlord faced with this situation. ■

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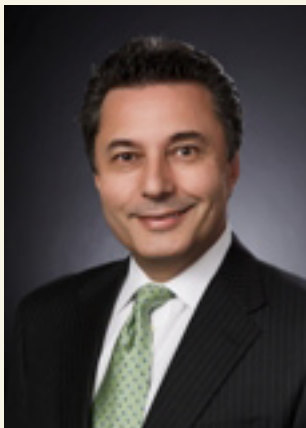
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