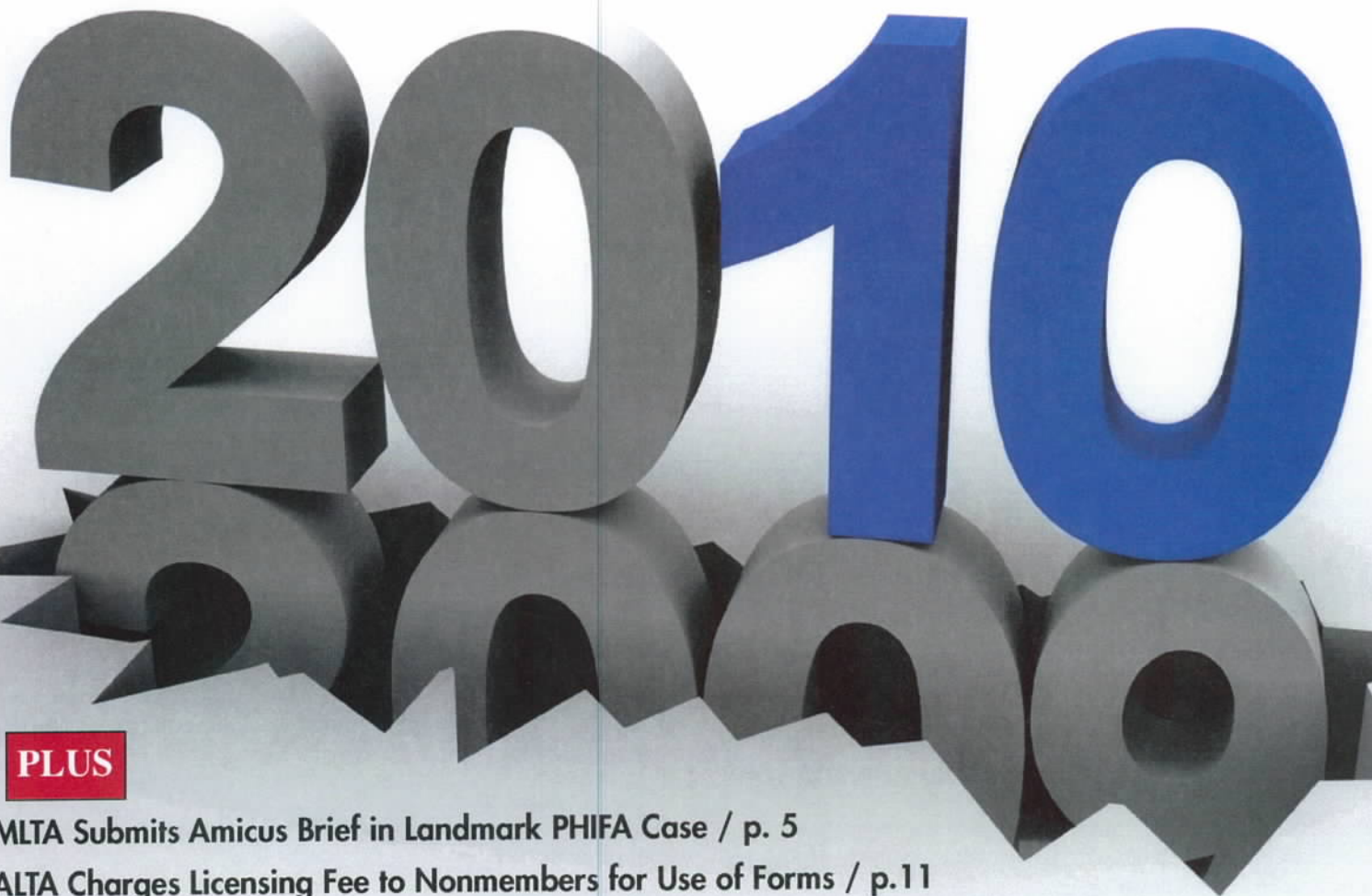


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Indemnity Deeds of Trust in Maryland

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In commercial transactions, Indemnity Deeds of Trust or "IDOTS" are sometimes used to secure loans made to a different but related business entity. IDOTS are deeds of trust securing contingent debt by someone, usually a guarantor, for the repayment of a debt by a third party borrower or "Debtor."¹ Since an IDOT involves a debt that has not yet been incurred, the recordation of an IDOT defers State Recordation Taxes. In large commercial transactions, this savings can be significant.

The Guarantor or Grantor under the IDOT is not primarily liable for the repayment of the debt, but merely guarantees that a third party, the Debtor, repays the debt in a timely fashion. Because the debt of the Guarantor is not incurred until the Debtor defaults, the IDOT is not subject to State Recordation Taxes. When the Debtor defaults and the lender makes demand for repayment from the Guarantor, then the debt becomes due, and recordation taxes become due.² However if the Debtor repays the debt and no default occurs, then no recordation tax is ever incurred.

The question has been asked in an opinion from the Office of the Attorney General, dated October 27, 1994, whether IDOTs need to state on their face a dollar amount of debt in order to be recordable. By the definition of an IDOT, there is no principal amount of debt yet incurred when the IDOT is recorded.³ Therefore, the IDOT does not need to state "a dollar amount of debt secured so long as the instrument clearly indicates that it secures obligations of a Grantor under an indemnity or guaranty agreement."

Since the State Recordation Tax is based on the amount of debt as it is incurred, the IDOT is

deemed exempt from such taxes until the debt becomes due under the IDOT (and Guaranty Agreement). However, Section 7-102 of the *Real Property Article of the Annotated Code of Maryland* states that no lien may be created against a property in excess of the face amount of the deed of trust or mortgage. State Recordation Tax is usually calculated based on this face amount or stated consideration.

One important exception to the use of IDOTS to defer the imposition of recordation taxes is the taxation of IDOTS in Prince George's County, Maryland. While most jurisdictions subject deeds of trust only to the State Recordation Tax, in Prince George's County, deeds of trust are generally subject to both the State Recordation Tax and the County Transfer Tax. Although an IDOT would be exempt from State Recordation Tax, it would still be subject to the County Transfer Tax of 1.4% of the stated consideration or loan amount.



There are practical aspects to recording IDOTS, especially as to what backup materials are required by the clerks in order to receive the exemption from State Recordation Tax. Generally the clerk will do two things, (1) review the IDOT itself to look for certain terms of the loan or for special phrase, and (2) review a copy of the note that is the basis of the debt.

The clerk is looking for confirmation that the debt under the IDOT is a contingent debt, and that the Guarantor is secondarily liable for the repayment of the debt. The IDOT should state on its face that the Guarantor is not primarily liable for the repayment of the debt but is merely guaranteeing the repayment of the debt by the Borrower. In addition to



the language contained in the IDOT, the clerk will want to review a copy of the note to confirm that only the Borrower (and not the Guarantor) has signed the note. Both steps are generally required in order for the IDOT to be eligible for the exemption.⁴

Counties also have specific forms that must be filed in order to record IDOTS. In particular, Montgomery County requires the presentation of an affidavit, signed under penalties of perjury, that the following requirements for exclusion from State Recordation Tax are met:

- The grantor of the IDOT is a separate and distinct entity from the maker of the note,
- The grantor of the IDOT has signed a guaranty of the note,
- The IDOT secures only the guaranty; and
- The grantor of the IDOT is not primarily liable for the indebtedness.

This Affidavit for Indemnity Deed of Trust only accompanies the IDOT to record; it is not intended to be recorded with the IDOT. However the statements made under the affidavit, either by the Lender's Attorney, Settlement Attorney, or Party to the IDOT, are made under penalties of perjury. While clerks generally do not require a review of the Guaranty Agreement, it is good practice to retain a copy at closing just in case the clerk asks to see the Agreement during the review process.

There is a downside to using IDOTs. There is a requirement that there be a Borrower and Guarantor in the transaction, with the Borrower signing the Note, and the Guarantor signing the IDOT and Guaranty Agreement. If the Borrower is a newly created entity, then the cost of creation is added to the overall costs of the transaction and detracts from the savings of using an IDOT. In addition, accounting and maintenance costs, including tax filings, add to the overall cost. These increased costs must be weighed against any savings obtained by using an IDOT structure.

While IDOTS remain a viable vehicle for reducing or eliminating State Recordation Taxes in commercial transactions, the future of IDOTS is uncertain. In recent years, there has been increasing pressure to eliminate the exemption for IDOTS. Legislation has been introduced at the state and local levels that would tax IDOTS; however, such legislation has not gained much traction. Given the relatively weak economic picture, it is not unreasonable to expect the reintroduction of such legislation in the future. In the meantime, IDOTS continue to remain exempt from State Recordation Taxes.

¹ See 58 Op. Att'y Gen. 792 (1973) and 74 Op. Att'y Gen. 281 (1989)

² See Section 12-105f of the Tax-Property Article of the Annotated Code of Maryland

³The Assistant Attorney General states in a footnote that, "The mere titling of a mortgage or deed of trust and indemnity or guaranty mortgage or deed of trust is not sufficient. The text of the instrument must clearly indicate that the interest in the property is being given to secure obligations of the grantor under an indemnity or guaranty agreement."

⁴ Although IDOTS actually defer the payment of State Recordation tax and are not a true exemption, the term "exemption" is generally used in describing the tax liability under an IDOT.