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Revenue

In this article John Orrick and William Hoffman, of Linowes and Blocher LLP, discuss Maryland legislation that allows refinanced commercial loans, whether secured by an indemnity deed of trust (IDOT) or other security interest, to escape recordation tax to the extent of the existing loan's outstanding principal balance. They note how refinancing is further facilitated by an increased exemption amount for IDOTs, and a new exemption for transfers between affiliated limited liability companies, which may be particularly beneficial in the context of forming special purpose entities.

2013 Maryland Legislation: Recordation and Transfer Tax Exemptions Expanded for IDOTs and Affiliated Entity Transfers

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Introduction

Two pieces of legislation signed into law by Governor O'Malley following the 2013 Maryland General Assembly will potentially lessen the burden of recordation and transfer taxes on certain financing transactions and on real property transfers between affiliated limited liability companies and corporations.

Recordation and transfer taxes in Maryland are assessed at the state and county level. Collectively, these taxes can be as high as 3 percent of the fair market

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value of the property being mortgaged or transferred, depending upon the local jurisdiction. As a result, the impact of these taxes can be significant on many transactions.

Senate Bill 436 (enacted as Chapter 267 of the Session Laws) amended Tax-Property Article 12 of the Annotated Code of Maryland, specifically revising §§ 12-101(l), 12-105(f)(7), and 12-108(e) and (g). With the new law, any borrower that refinances a commercial loan, whether secured by an indemnity deed of trust or otherwise, will be taxed only on the "new money" – the difference between the outstanding principal balance of the existing loan and the outstanding principal balance of the new loan.

An indemnity deed of trust that secures a guaranty of a loan or series of loans that do not exceed \$3 million will be exempt from recordation tax under revised § 12-105(f)(7)(iii)(2).

Senate Bill 202 (enacted as Chapter 452 of the Session Laws) provided that the existing exemption from recordation and transfer taxes for transfers of real property between related corporations is now also available to transfers between related limited liability companies, through amendments to §§ 12-108(p) and 13-207(a) of the Tax-Property Article.

All of these amendments became effective on July 1, 2013.

Recordation Taxes— Indemnity Deeds of Trust (IDOT)

Senate Bill 436¹ amended §§ 12-101, 12-105, and 12-108 of the Tax-Property Article of the Annotated Code of Maryland.

IDOTs that secure a guarantee of repayment of a loan, or series of loans that are part of the same transaction, are now exempt from recordation tax for loan amounts less than \$3 million, thereby increasing the prior exemption amount by \$2 million.

Statutory Background. Section 12-102 of the Tax-Property Article imposes a tax on instruments of writing recorded with the clerk of the circuit court of a county or filed with the State Department of Assessments and Taxation. An instrument of writing is defined as including a written instrument that “creates or gives notice of a security interest in real property.”² An instrument of writing specifically includes “a mortgage, deed of trust, or other contract that creates an encumbrance on real property.”³ The recordation tax on deeds of trust is based on “the principal amount of the debt secured” by the deed of trust.⁴

IDOTs. An indemnity deed of trust (IDOT) works as follows: a lender agrees to loan money to a borrower on two conditions: (i) a third party guarantor (oftentimes an affiliate of the borrower) guarantees repayment of the loan, and (ii) the guarantor executes a mortgage or deed of trust on real property owned by it to secure the guaranty, which instrument is recorded in the land records in a similar fashion to a conventional mortgage or deed of trust to establish a lien on the property.

Prior to July 1, 2012, there was no tax owing with respect to the recordation of an IDOT based upon the reasoning expressed in a 1989 Maryland Attorney General’s Opinion,⁵ that the deed of trust securing the third-party guaranty of a commercial loan was a contingent obligation until the guaranty was actually invoked by the lender. Legislation adopted last year by the Maryland General Assembly and signed by the Governor, which took effect July 1, 2012, removed this exemption, applying recordation tax in the same manner as if the guarantor were primarily liable for the loan, except

where loan amounts of less than \$1 million were secured by the IDOT. The 2013 legislation increases the exemption from recordation tax for IDOTs. Thus, IDOTs that secure a guarantee of repayment of a loan, or series of loans that are part of the same transaction, are now exempt from recordation tax for loan amounts less than \$3 million, thereby increasing the prior exemption amount by \$2 million.

In order to take advantage of the refinance partial exemption, the new deed of trust needs to include a statement, or be accompanied by an “affidavit signed under oath” by the original mortgagor or its agent, that the grantor of the refinancing instrument is the original mortgagor and recite the current outstanding principal balance of the mortgage, deed of trust or IDOT that is being refinanced.

Further, the legislation confirms that recordation tax is due on the refinancing of a loan secured by an existing IDOT (regardless of whether recordation tax was paid on the original IDOT) only to the extent that “new money” is secured in excess of the outstanding principal balance of the guaranteed loan immediately prior to the date of the transaction.

For example, as a result of the new legislation, if an existing IDOT securing a guaranty of an outstanding loan that has a principal balance of \$2 million is amended to secure a loan of \$3,500,000, recordation tax would be owed on \$1,500,000 – the amount of the “new money.” On the other hand, were the principal amount of the guaranteed loan increased to only \$2,900,000, there would be no recordation tax owing as the total amount secured is less than \$3 million.

Of significance, the aforementioned partial exemption for refinancing existing loans applies not only to IDOTs, but to any mortgage or deed of trust securing a commercial loan, regardless of the outstanding amount of the refinanced loan. Accordingly, when any commercial loan is refinanced with a new deed of trust, recordation tax is due only on the additional amount of the loan secured over the outstanding principal balance of the existing loan. Formerly, this refinancing partial exemption was only available in the case of mortgages or deeds of trust on principal residences.

In order to take advantage of the refinance partial exemption, the new deed of trust needs to include a statement, or be accompanied by an “affidavit signed under oath” by the original mortgagor or its agent, that the grantor of the refinancing instrument is the original mortgagor and recite the current outstanding principal balance of the mortgage, deed of trust or IDOT that is being refinanced.

¹ Act of May 2, 2013, ch. 267, 2013-pamph. no. 2 Md. Code Ann. Adv. Leg. Serv. 1158 (LexisNexis)(to be codified at Md. Code Ann. Tax-Prop. §§ 12-101(l), -105(f)(7), -108(e) & (g)), <http://mgaleg.maryland.gov/webmga/frmLegislation.aspx?pid=legisnpage&tab=subject3>.

² Md. Code Ann. Tax-Prop. § 12-101(f)(1)(ii).

³ Md. Code Ann. Tax-Prop. § 12-101(f)(2)(ii).

⁴ Md. Code Ann. Tax-Prop. § 12-103(a).

⁵ 74 Opinions of the Attorney General 281 (1989) (following 58 Opinions of the Attorney General 792 (1973)).

Recordation and Transfer Taxes— Transfer of Property Between Related Entities Exemption

Senate Bill 202⁶ amended §12-108(p) and §13-207(a)(9) of the Tax-Property Article of the Annotated Code of Maryland, which provides an exemption from state recordation and transfer taxes for the transfer of real property between a parent “business entity” and its wholly owned subsidiary or between subsidiaries wholly owned by the same parent “business entity.” There is an existing parallel exemption for County transfer taxes under §13-405 of the Tax-Property Article.

An exemption had existed previously under §12-108(p) for transfers between affiliated corporate entities of this nature; however, the 2013 legislation expands the definition of “business entity” to include limited liability companies as well as corporations.

As originally passed by the State Senate, there was a five year “sunset” provision on these amendments. This sunset provision was removed during the conference committee, and the amendments are permanent.

Accordingly, a corporation or a limited liability company which currently owns real property may transfer the property, or a portion thereof, into an existing or newly formed wholly-owned limited liability company or corporation without payment of recordation or transfer tax provided that the transfer is made for no or nominal consideration other than the issuance, cancellation, or surrender of the ownership interests of the

subsidiary business entity. This should greatly facilitate the refinancing of properties where lenders require the formation of special purpose entities as a condition to financing or refinancing development, or redevelopment, of properties.

A transfer of real property between two business entities wholly owned by the same corporation, or limited liability company, is also exempt subject to the same proviso.

Transfers of real property from a subsidiary business entity to its parent business entity for no or nominal consideration may also be made without payment of any recordation or transfer tax provided that one of the following conditions are satisfied: (i) the parent business entity previously owned the real property; (ii) the parent business entity held the ownership interests of the subsidiary business entity for a period greater than eighteen months; or (iii) the parent business entity acquired ownership of the subsidiary business entity which has been in existence and has owned the real property for a period of at least two years.

Linowes and Blocher attorneys were instrumental in the passage of this legislation.

For additional information on either of these pieces of legislation, please contact Jack Orrick at 301-961-5213 or jorrick@linowes-law.com, or Bill Hoffman at 301-961-5212 or whoffman@linowes-law.com.

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⁶ Act of May 16, 2013, ch. 452, 2013-pamph. no. 4 Md. Code Ann. Adv. Leg. Serv. 288 (LexisNexis)(to be codified at Md. Code Ann. Tax-Prop. §§12-108(p) & 13-207(a)(9)), <http://mgaleg.maryland.gov/webmga/frmLegislation.aspx?pid=legisnpage&tab=subject3>.