

Department of Legislative Services
Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE
Revised

House Bill 1236
Ways and Means

(Delegate Hixson, *et al.*)

Budget and Taxation

Recordation and Transfer Taxes - Low Income Housing Projects - Controlling Interest

This bill establishes the consideration used to calculate the recordation tax and the State and county transfer tax on transactions for which a controlling interest is conveyed in a real property entity that has developed real property under Section 42 of the Internal Revenue Code, the Low Income Housing Tax Credit Program. For purposes of the recordation tax and the State and county transfer tax, the consideration is the actual payment made by the purchaser to the seller for the purchase of the interest.

The bill takes effect July 1, 2013, and applies to all instruments of writing recorded or filed on or after July 1, 2013.

Fiscal Summary

State Effect: State transfer tax revenues decrease beginning in FY 2014. The amount of the decrease depends on the number of property transfers that occur, the value of the transferred interest, and the assessed value of the property. Expenditures are not affected.

Local Effect: Local recordation and transfer tax revenues decrease beginning in FY 2014. The amount of the decrease depends on the number of property transfers that occur, the value of the transferred interest, and the assessed value of the property. Local expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Current Law: Chapter 3 of the 2007 special session (SB 2) imposed recordation and transfer taxes on the transfer of real property with a value of \$1 million or more when the transfer is achieved through the sale of a “controlling interest” in a specified corporation, partnership, limited liability company, limited liability partnership, or other form of unincorporated business. Controlling interest is defined as more than 80% of the total value of the stock or the interest in capital and profits.

Specifically, the legislation (1) applies to transfers of controlling interests by entities that have tangible assets of which at least 80% are comprised of real property in Maryland that has an aggregate value of at least \$1 million; (2) exempts certain transfers (*e.g.*, mergers and dissolutions); and (3) requires a report be filed with the State Department of Assessments and Taxation (SDAT) upon the transfer of a controlling interest within 30 days of the final transfer.

The tax is to be imposed on the consideration payable for the transfer of controlling interest in the real property entity reduced by the amount allocable to assets other than the real property. Consideration includes any mortgage, deed of trust, or other lien on the real property directly or beneficially owned by the real property entity and any other debt or encumbrance of the real property entity. The entity has the burden of establishing the consideration related to the real property, and if it fails to do so the tax is imposed on the most recent assessed value of the property.

Background: The counties and Baltimore City are authorized to impose locally established recordation tax rates on any business or person (1) conveying title to real property or (2) creating or giving notice of a security interest (*i.e.*, a lien or encumbrance) in real or personal property, by means of an instrument of writing.

The State and most counties impose a transfer tax. The State transfer tax rate is 0.5% of the consideration payable for an instrument of writing conveying title to, or a leasehold interest in, real property (0.25% for first-time Maryland homebuyers). In some jurisdictions, a local property transfer tax may be imposed on instruments transferring title to real property. A distinction is made in the local codes between instruments transferring title such as a deed and certain leaseholds and instruments securing real property such as a mortgage.

For purposes of local recordation taxes, which are applied to each \$500 or fraction of \$500 of consideration payable or of the principal amount of the debt secured for an instrument of writing, the consideration includes the amount of any mortgage or deed of trust assumed by the grantee. For purposes of the State transfer tax, the consideration includes the amount of any mortgage or deed of trust assumed by the grantee.

County governments collected \$511.7 million in local recordation and transfer taxes in fiscal 2011 and are expected to collect \$511.5 million in fiscal 2012 and \$532.0 million in fiscal 2013. These amounts are significantly lower than the amounts collected in fiscal 2006 when the soaring real estate market yielded recordation and transfer taxes totaling \$1.2 billion. **Exhibits 1 and 2** show current recordation and transfer tax rates and estimated local recordation and transfer tax collections for fiscal 2012 and 2013.

Federal Low Income Housing Tax Credit

The federal Low Income Housing Tax Credit Program (LIHTC) was established by the Tax Reform Act of 1986. The tax credit subsidizes the construction and rehabilitation of low-income rental housing and is intended to encourage the production of low-income residential rental housing. Instead of offering direct subsidies, the LIHTC provides incentives by granting investors a dollar-for-dollar reduction in their federal tax liability in exchange for providing funds for the development of qualified, affordable rental housing. This allows rents for some of a project's units to be set below market level while the investors receive annual tax credit allotments over 10 years. For at least 15 years after completion, a project must continue to meet the LIHTC eligibility requirements, such as maintaining the units as affordable to the target population.

The federal Low Income Housing Tax Credit can only be claimed for a qualified project – any project for residential rental property that meets requirements for low-income tenant occupancy, gross rent restrictions, state credit authority, and Internal Revenue Service certification. A project must continue to meet these requirements for 15 years or the credit is subject to recapture.

State Fiscal Effect: The bill specifies that for purposes of the State transfer tax, the consideration is the actual payment made by the purchaser to the seller for the purchase of the interest. To the extent that the actual payment made by the purchaser is less than the property value, State transfer tax revenues will decrease. The amount of the decrease cannot be reliably estimated and depends on the number of property transfers that occur, the value of the transferred interest, and the assessed value of the property.

Typically, for projects developed utilizing LIHTC, the limited partner interest is transferred to the general partner of a related party at the end of the property's initial 15-year tax credit period. Usually, the amount paid to the exiting partner is some portion of their original equity investment and in many cases is as low as their federal and state income tax and capital gains obligations. Under current law, the method of calculating the transfer and recordation taxes on transferred partnership interest is based on the value of the real estate and not on the actual transfer payment. The Maryland Low Income Housing Coalition estimates that about 28 LIHTC properties reach the maximum 15-year tax credit period each year and approximately 20 of these properties may involve the

transfer of ownership. The bill alters the calculation of transfer and recordation taxes so that the tax applies to the actual payment made by the purchaser to the seller for the purchase of the interest rather than on the value of the property.

As a point of reference, *for illustrative purposes only*, if a LIHTC property with a real property value of \$5.0 million is transferred, under current law the State will collect \$25,000 in transfer taxes; under the bill, if the tax is collected on the purchase of partnership interest valued at \$3.5 million, the State will collect \$17,500 in transfer taxes, or \$7,500 less than under current law.

Local Fiscal Effect: The bill specifies that for purposes of the local recordation and transfer taxes, the consideration is the actual payment made by the purchaser to the seller for the purchase of the interest. To the extent that the actual payment made by the purchaser is less than the property value, local recordation and transfer tax revenues will decrease. The amount of the decrease cannot be reliably estimated and depends on the number of property transfers that occur, the value of the transferred interest, and the assessed value of the property.

As a point of reference, *for illustrative purposes only*, if a LIHTC property in Montgomery County with a real property value of \$5.0 million is transferred, under current law Montgomery County will collect \$34,500 in recordation taxes and \$50,000 in transfer taxes; under the bill, if the tax is collected on the purchase of partnership interest valued at \$3.5 million, Montgomery County will collect \$24,150 in recordation taxes and \$35,000 in transfer taxes, or \$25,350 less than under current law.

Exhibit 1
County Recordation Tax Collections
Fiscal 2012 and 2013

County	Tax Rate	FY 2012	FY 2013
Allegany	\$3.50	\$1,070,079	\$975,000
Anne Arundel	3.50	28,000,000	30,000,000
Baltimore City	5.00	20,481,000	20,197,000
Baltimore	2.50	21,168,152	21,519,336
Calvert	5.00	5,500,000	5,500,000
Caroline	5.00	1,200,000	1,100,000
Carroll	5.00	8,000,000	8,000,000
Cecil	4.10	4,000,000	4,500,000
Charles	5.00	10,000,000	10,500,000
Dorchester	5.00	1,849,386	1,534,386
Frederick	6.00	10,442,200	15,097,069
Garrett	3.50	2,200,000	1,900,000
Harford	3.30	10,200,000	7,754,000
Howard	2.50	16,000,000	17,000,000
Kent	3.30	700,000	847,368
Montgomery	3.45	49,688,677	49,288,845
Prince George's	2.75	22,251,000	28,063,600
Queen Anne's	4.95	2,650,000	2,331,752
St. Mary's	4.00	4,600,000	4,500,000
Somerset	3.30	373,132	440,000
Talbot	6.00	4,250,000	4,365,000
Washington	3.80	4,550,000	4,550,000
Wicomico	3.50	2,134,000	2,249,756
Worcester	3.30	5,750,000	5,750,000
Total		\$237,057,626	\$247,963,112

Source: Department of Legislative Services

Exhibit 2
County Transfer Tax Collections
Fiscal 2012 and 2013

County	Tax Rate	FY 2012	FY 2013
Allegany	0.50%	\$395,000	\$350,000
Anne Arundel	1.00%	29,000,000	30,000,000
Baltimore City	1.50%	21,541,000	21,973,000
Baltimore	1.50%	43,531,045	44,000,000
Calvert	0.00%	0	0
Caroline	0.50%	304,602	365,397
Carroll	0.00%	0	0
Cecil	\$10/deed	23,000	23,500
Charles	0.00%	0	0
Dorchester	0.75%	760,084	719,115
Frederick	0.00%	0	0
Garrett	1.00%	1,200,000	1,200,000
Harford	1.00%	11,200,000	9,600,000
Howard	1.00%	22,327,512	22,000,000
Kent	0.50%	335,000	355,000
Montgomery	1.00%	74,200,000	80,650,000
Prince George's	1.40%	59,339,200	62,306,200
Queen Anne's	0.50%	0	400,000
St. Mary's	1.00%	3,900,000	3,900,000
Somerset	0.00%	0	0
Talbot	1.00%	2,250,000	2,250,000
Washington	0.50%	1,331,163	1,200,000
Wicomico	0.00%	0	0
Worcester	0.50%	2,750,000	2,750,000
Total		\$274,387,606	\$284,042,212

Source: Department of Legislative Services

Additional Information

Prior Introductions: None.

Cross File: SB 730 (Senator King, *et al.*) - Budget and Taxation.

Information Source(s): Baltimore City, Kent County, Department of Housing and Community Development, Judiciary (Administrative Office of the Courts), Maryland Low Income Housing Coalition, Department of Legislative Services

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