Department of Legislative Services

Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE
Revised

House Bill 1209 (Delegate Frick, *et al.*)
Ways and Means Budget and Taxation

Recordation Taxes - Exemptions

This bill makes several changes related to the application of local recordation taxes with regards to indemnity mortgages. The bill clarifies that only indemnity mortgages recorded on or after July 1, 2012, are subject to recordation tax on the original loan amount. In addition, the bill (1) increases the value of an indemnity mortgage that is exempt from recordation tax to $3.0 million; (2) requires that a series of indemnity mortgages that are part of the same transaction must be considered as one for purposes of the recordation tax; (3) allows indemnity mortgages recorded before July 1, 2012, to be amended without incurring the recordation tax on the original loan amount; (4) alters the definition of supplemental instrument of writing to include an instrument of writing that amends and restates a previously recorded instrument of writing regardless of whether the recordation tax was paid on such an instrument of writing; (5) specifies that an indemnity mortgage that is recorded in multiple counties is not subject to the recordation tax on the full value of the mortgage in each county; (6) requires that recordation tax be paid on the difference between the unpaid principal balance of the original loan and the amount of any new loan; and (7) allows commercial mortgages, including indemnity mortgages, to be refinanced without incurring recordation tax in the same manner as residential mortgages.

The bill takes effect July 1, 2013.

Fiscal Summary

State Effect: General fund revenues decrease as a result of commissions not being collected by the clerks of the circuit court. Expenditures are not affected.

Local Effect: Potential significant reduction in local recordation tax revenues beginning in FY 2014. Local expenditures are not affected.

Small Business Effect: Potential meaningful.

Analysis

Current Law: Chapter 2 of the 2012 first special session (SB 1302) applied the recordation tax to an "indemnity mortgage" in the same manner as if the guarantor were primarily liable for the guaranteed loan, unless the recordation tax is paid on another instrument of writing that secures the payment of the guaranteed loan or the indemnity mortgage secures a guarantee of repayment of a loan for less than $1.0 million. An indemnity mortgage includes any mortgage, deed of trust, or other security interest in real property that secures a guarantee of repayment of a loan for which the guarantor is not primarily liable.

An indemnity mortgage works as follows. A lender agrees to loan money to a borrower on two conditions: (1) that a third party guarantees repayment of the loan; and (2) that the guarantor executes a mortgage on real property to secure the guarantee. An indemnity mortgage is the instrument that manifests the pledge of the property. An indemnity mortgage is recorded so as to establish a lien on the property.

The indemnity mortgage provision of Chapter 2 was intended to eliminate a purported tax avoidance transaction in which an entity, in order to avoid the recordation tax on a deed of trust, creates a limited liability company (LLC) and has the LLC borrow money with a third party as the guarantor of the debt. In that case, no recordation tax is paid on the LLC borrowing or the third-party guarantee.

A supplemental instrument of writing is not subject to the recordation tax except to the extent that (1) actual consideration is payable on the supplemental instrument of writing or (2) the amount of debt is increased by the supplemental instrument of writing.

An original mortgagor is an individual who assumed a debt secured by real property that the individual purchased as a principal residence and who paid the recordation tax on the consideration paid for the property, and the trustee of an inter vivos trust if the mortgaged property is used as a principal residence of the settlor of the trust and the trustee or the settlor of the trust originally assumed or incurred the debt secured by the mortgage or deed of trust.

A mortgage or deed of trust is not subject to recordation tax to the extent that it secures the refinancing of an amount not greater than the unpaid principal amount secured by an existing mortgage or deed of trust at the time of refinancing if the mortgage or deed of trust secures the refinancing of real property that is (1) used as a principal residence by the original mortgagor being refinanced by the original mortgagor or by the original mortgagor and the spouse of the original mortgagor or (2) used as a principal residence by the settlor of an inter vivos trust if the mortgage or deed of trust is given by a trustee of the trust.

To qualify for this exemption, an original mortgagor or agent of the original mortgagor must include a statement in the recitals or in the acknowledgment of the mortgage or deed of trust, or submit with the mortgage or deed of trust, an affidavit under oath, signed by the original mortgagor or agent of the original mortgagor, stating (1) that the individual is the original mortgagor or agent of the original mortgagor; (2) that the mortgaged property is the principal residence of the original mortgagor or of the settlor of an inter vivos trust if the mortgage or deed of trust is given by a trustee of the trust; and (3) the amount of unpaid principal of the original mortgage or deed of trust that is being refinanced.

Background:

Chapter 2 of the 2012 First Special Session

The fiscal and policy note for Chapter 2 estimated that local government revenues would increase significantly beginning in fiscal 2013, depending on the number of transactions occurring each year and the value of each transaction. Based on estimates for recent transactions in some counties, it was estimated that total recordation tax revenues could increase by $34.5 million in fiscal 2013, as shown in **Exhibit 1**. However, any increases may vary from year to year and are dependent on local economic development activity. The estimate was based on information provided by the counties and Baltimore City at the request of the Department of Legislative Services and the Maryland Association of Counties.

Exhibit 1
Estimated Recordation Tax Revenue Increase
Indemnity Mortgages

County	Fiscal 2013
Allegany*	$107,000
Anne Arundel	2,925,000
Baltimore City	400,000
Baltimore	2,100,000
Calvert*	550,000
Caroline	100,000
Carroll*	800,000
Cecil	1,000,000
Charles*	1,000,000
Dorchester*	185,000
Frederick	5,000,000
Garrett*	220,000
Harford*	1,020,000
Howard	2,903,000
Kent*	70,000
Montgomery	11,000,000
Prince George's	2,500,000
Queen Anne's*	500,000
St. Mary's	500,000
Somerset*	40,000
Talbot*	565,000
Washington*	455,000
Wicomico	350,000
Worcester	250,000
Total	**$34,540,000**

*Based on 10% increase over estimated fiscal 2012 recordation tax revenues.
Source: Maryland Association of Counties; Department of Legislative Services

Indemnity Mortgage and Deed of Trust (IDOT) Workgroup

Chapter 2 also required the Director of the State Department of Assessments and Taxation to form a workgroup to study the impacts of imposing the recordation tax on indemnity mortgages and deeds of trust.

The workgroup was required to study (1) the expected tax revenues to be collected for local governments; (2) the impacts of the tax, if any, on the forms, volumes, and value of commercial real estate transactions in urban, suburban, and rural areas of the State and on the overall commercial real estate market in the State; and (3) the impacts of the tax, if any, on residential real estate transactions.

The workgroup met several times over the 2012 interim and issued a report in December 2012. The State Archives provided customized monthly listings of all commercial deed of trust transactions in the land records for 11 jurisdictions (Baltimore City and Anne Arundel, Baltimore, Caroline, Cecil, Harford, Howard, Montgomery, Queen Anne's, Washington, and Worcester counties) that were used to provide a representative sample. The workgroup then compared transactions for the months of August, September, and October 2012, after the law took effect, with transactions in the same three-month period in 2011.

The workgroup's final report contained the following findings: (1) the data collected for the two comparative periods indicates that the fiscal estimate of the tax revenues to be collected by local governments in the enabling legislation (SB 1302) will be met or exceeded for most jurisdictions in the State; (2) the volume of commercial transactions since the effective date of the new law is down, although tax revenues have increased in urban, suburban, and rural areas alike within the jurisdictions; (3) neither the data collected nor the survey responses provided sufficient information to determine the impact on residential transactions; and (4) the full impact of the new law cannot be evaluated in the few months after the law's July 1, 2012 effective date.

Local Recordation Taxes

The county governments 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. Local recordation tax rates range from $2.50 per $500 in Baltimore and Howard counties to $6.00 per $500 in Frederick and Talbot counties.

County governments are expected to collect $237.1 million in local recordation taxes in fiscal 2012 and $248.0 million in fiscal 2013. These amounts are significantly lower than the amounts collected in fiscal 2006 when the soaring real estate market yielded recordation taxes totaling $619.0 million. **Exhibit 2** shows current recordation tax rates and estimated local recordation tax collections for fiscal 2012 and 2013. The revenue estimates for fiscal 2013 were primarily developed prior to the enactment of SB 1302.

Exhibit 2
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

State Fiscal Effect: The clerks of the circuit court in several jurisdictions collect a number of different taxes and fees, including local recordation taxes. The Administrative Office of the Courts reports that, as of fiscal 2012, the clerk of the circuit court collects local recordation taxes in the following 13 jurisdictions: Allegany, Calvert, Dorchester, Garrett, Harford, Kent, Queen Anne's, St. Mary's, Somerset, Talbot, Washington, Wicomico, and Worcester. In the remaining jurisdictions, local finance offices are responsible for the collection of these taxes. The clerks of the court who collect the tax are entitled to a commission of between 3% and 5% of all public monies collected, which, unless otherwise specified, are remitted to the State's general fund. As a result, any decrease in local recordation tax revenue will also decrease the amount of the commissions collected by the clerks and remitted to the general fund.

Local Fiscal Effect: The bill reduces local recordation taxes relating to indemnity mortgages in several ways. The bill exempts the amount of debt to be secured by an indemnity mortgage or deed of trust recorded before July 1, 2012, when it is amended or restated regardless of whether the tax was paid when the original indemnity mortgage was recorded. The bill also increases the minimum amount an indemnity deed of trust has to secure before being taxable from $1.0 million to $3.0 million, thereby subjecting fewer indemnity deeds of trust to recordation taxes than under current law. Finally, recordation tax revenues will also decrease as a result of extending a refinancing exemption to commercial properties and secondary residential properties that is currently available to only owner-occupied residential real property.

As a result, it is estimated that local recordation tax revenues will decrease by a potentially significant amount beginning in fiscal 2014. However, the exact amount of the revenue decrease cannot be reliably estimated and depends on the number of specified transactions that occur each year and the value of the consideration of these transactions.

As noted, the IDOT workgroup examined transactions for the same three-month period in 2011 (before Chapter 2) and 2012 (after Chapter 2). Based on an analysis of the data, the workgroup estimated that recordation taxes in the 11 jurisdictions that were examined may increase by approximately $47.5 million on an annualized basis. However, the workgroup also noted that the estimate may be overstated as it only had data for three months and there were several large transactions during that period that may not be indicative of an entire year of tax collections.

Exhibit 3 shows a comparison of transactions and the consideration for the three-month review periods in both 2011 and 2012. The number of transactions decreased by 17.6%, while the total consideration decreased by 52.1%. In addition, transactions with a consideration of less than $1.0 million comprised 5.2% of the total in the 2012 review period, compared to 2.6% in the 2011 review period; transactions with a consideration between $1.0 million and $5.0 million comprised 8.2% of the total in 2012 (5.5% in 2011); transactions between $5.0 million and $10.0 million comprised 6.5% of the total in 2012 (4.7% in 2011); and transactions of over $10.0 million comprised 80.0% of the total in 2012 (87.2% in 2011).

As a point of reference, increasing the recordation tax threshold for indemnity mortgages from $1.0 million to $3.0 million may reduce total local revenues by approximately $2.0 million in the 11 jurisdictions reviewed by the IDOT study group. These jurisdictions make up approximately 66% of the total recordation taxes that were estimated to be collected from the IDOT provision of Chapter 2. It is estimated that revenues for all counties may decrease by $3.0 million. This estimate is based on the percentage of the consideration between $1.0 million and $5.0 million for transactions that occurred between August and October 2012 and a partial reduction to account for the lower $3.0 million threshold.

The above estimate only includes the potential revenue effect of increasing the taxable threshold for indemnity mortgages from $1.0 million to $3.0 million and does not include other provisions of the bill which may also have a significant effect on local recordation tax revenues.

As noted previously, for indemnity mortgages filed prior to July 1, 2012, the bill exempts the entire amount of an original indemnity mortgage or deed of trust when it is amended or restated regardless of whether the tax was paid when the original indemnity mortgage was recorded; and exempts those mortgages or deeds of trust on properties other than a principal residence that are refinanced for an amount not greater than the debt secured by an existing mortgage at the time of refinancing. The amount of the revenue decrease associated with these provisions cannot be reliably estimated and depends on the value of these transactions and the frequency to which they occur, but the amount of the decrease to local recordation tax revenue may be significant.

Exhibit 3
Comparison of Commercial Transactions
($ in Thousands)

	Transactions		**Consideration**	
Transaction Value	**2011**	**2012**	**2011**	**2012**
Less than $1 million	1,037	918	$278,374.5	$264,209.0
$1 – $5 million	268	185	587,760.5	421,713.0
$5 – $10 million	78	47	497,714.5	334,824.0
Over $10 million	124	92	9,317,259.5	4,091,308.0
Total	**1,507**	**1,242**	**$10,681,109.0**	**$5,112,054.0**

Source: IDOT Workgroup, December 2012

Additional Information

Prior Introductions: None.

Cross File: SB 436 (Senator Peters, *et al.*) - Budget and Taxation.

Information Source(s): Baltimore City; Calvert, Howard, and Montgomery counties; Maryland Association of Counties; State Department of Assessments and Taxation; Judiciary (Administrative Office of the Courts); Department of Legislative Services

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