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January 19th, 2023
Senate Budget & Taxation Committee
The Honorable Guy Guzzone
3 West Miller Senate Building
Annapolis, Maryland 21401

Re: Senate Bill – 65 - Recordation Tax – Purchase Money Mortgage or Purchase Money Deed of Trust – Extent of Exemption

Dear Chairman Guzzone and Members of the Committee,

It is a great pleasure to appear before the Senate Budget and Tax Committee this afternoon in order to present Senate Bill 65.

As I am sure the members of this Committee are aware, Maryland imposes a recordation tax at the time that deeds, mortgages and deeds of trust are recorded in the county or city land records offices. The tax revenues accrue to the local jurisdiction and in fact are an important source of income to the jurisdiction. The tax is based upon the sale price of land being transferred in the case of deeds or upon the amount of the loan in the case of mortgages and deeds of trust.

Tax Property Article Section 12-108 grants several exemptions from the recordation tax. One of the most important exemptions is for what are known as "purchase money mortgages" and "purchase money deeds of trust". These instruments secure loans made to finance the purchase price of real property and are recorded at the same time as the deed transferring the property to its new owner. The exemption thus avoids the double payment of tax at the time that property changes hands, one tax on the amount of the purchase price, paid upon the recordation of the deed, and a second tax on the amount of the loan that enables the buyer to pay for the property, paid upon the recordation of the mortgage or deed of trust.

Up until recently, all Maryland real property attorneys understood that in the unusual case that the amount of the loan exceeded the purchase price of the piece of real estate, the mortgage or deed of trust was only a "purchase money mortgage" or "purchase money deed of trust" to the extent of the purchase price and that any additional loan amount would not be considered a "purchase price mortgage" or "purchase price deed of trust" and therefore would be subject to recordation tax.

So what is this bill all about? Let me illustrate it with this example.

Baltimore City has a huge inventory of abandoned homes. It sells one to a developer for $5,000. The developer takes out a loan for $150,000 to fix up the home. When the deed is recorded in the land records, a recordation tax is due on the $5,000 purchase price. When the deed of trust to secure the $150,000 loan is recorded, one would expect that $5,000 would be exempt from recordation tax and that the remaining $145,000 would be taxable.

Recently, however, a resourceful Chicago lawyer carefully read the actual language of the current statute. It provides that a purchase money mortgage or deed of trust secures the purchase price "in whole or in part". Exploiting an arguable ambiguity, the Chicago lawyer has argued that because, in my example, the deed of trust secures "in part" the $5,000 purchase price, there is no recordation tax due at all upon the recordation of the entire $150,000 deed of trust.

Senate Bill 65 simply clarifies the language of the recordation tax statute so that the arguable ambiguity is eliminated. It adds eight words to the statute, stating that a purchase money mortgage or purchase money deed of trust is not subject to recordation tax **to the extent that it secures purchase money**. This will clarify that in my example, $5,000 of the deed of trust qualifies as a purchase money deed of trust and will not be taxed, but the remaining $145,000 of the deed of trust will not qualify as a purchase money deed of trust and will be taxed.

I appreciate the Committee's consideration of Senate Bill 65.

Machen written testimony on SB 65 2023.pdf
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TO: Senate Budget and Taxation Committee

FROM: John P. (Jack) Machen, Special Chief Solicitor, Baltimore City Law Department

RE: Testimony in Support of SB 65 (Amendment to Tax Property Article §12-108(i) Recordation Tax – Purchase Money Mortgage or Purchase Money Deed of Trust – Extent of Exemption)

DATE: January 18, 2023

Pursuant to Tax Property Article §12-105, the State of Maryland imposes a recordation tax on mortgages and deeds of trust that are recorded in the land records. Tax Property Article §12-108 grants a number of exemptions from the recordation tax, among them, under subclause (i), an exemption for a mortgage or deed of trust that secures a loan made to <u>finance the purchase price</u> of real property.

The reason for the exemption is that the buyer/borrower has paid the recordation tax on the deed, and therefore assessing the tax on the accompanying purchase money mortgage is deemed an unfair double tax on the same dollars.

Here is the problem. Tax Property Article 12-108(i) defines purchase money mortgage as one that (among other things) secures the purchase price "in whole or in part" and further provides that any mortgage that meets the definition is exempt. A literal interpretation leads to the conclusion that all it takes is some purchase money, no matter how small, to exempt a mortgage of any size.

For example, a developer buys a property for $1 million and wants to construct a building costing $10 million. The developer borrows $11 million. Developer argues that the entire $11 million mortgage is exempt because it secures purchase money "in part."

Baltimore City, the jurisdiction that I represent, as well as other counties with which I have conferred, take the position that this is abusive. The purpose of the purchase money mortgage exemption is to avoid unfairly taxing the purchase price twice: once on the deed and again on the mortgage. It was never the intent to piggy-back the purchase money exemption on an otherwise fully taxable construction loan.

This has long been the position of the Maryland Attorney General's office. The exemption exists only to the extent that recordation taxes have been paid on the accompanying deed:

> [Purchase money mortgages are] exempt from the tax because of the fact that they are executed and recorded simultaneously with a deed conveying the property to the mortgagor [in circumstances in which a] tax on the full price paid for the property is paid upon the recording of the deed. . . . *24 Op. Md. Att'y Gen. 981 (1939)*.

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> Since this particular exemption is limited to the amount of the purchase money consideration, any future advance under the deed of trust is "additional debt" … which requires that recordation tax on the amount of such additional debt be paid by the debtor before it is incurred." *50 Md. A.G. Op. 428 (1965)*.

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> The grantee's mortgage or deed of trust will qualify for the purchase money mortgage/deed of trust exemption from State recordation tax only to the extent recordation tax was paid on the deed. … This exemption is designed to avoid double taxation. To the extent recordation tax is collected on the purchase money (consideration payable) set forth in the deed, recordation tax will not be collected again on the purchase money secured by the mortgage/deed of trust given as part of the same transaction. *Letter of Advice dated July 9, 1996 from Asst Atty Gen. Julia Freit to Charles C. Keller, Clerk.*

The courts have likewise respected this position and adopted the common sense interpretation that "The rationale behind the Maryland exemption from recordation tax is simply to avoid double taxation of both the deed and the purchase money deed of trust." *Case of Eastmet Corp.*, 907 F.2d 1487 (4th Cir. 1990).

This has also been the long-standing practice of real estate attorneys and title companies that whenever a loan combines purchase money along with construction financing, the security instrument would be captioned "Partial Purchase Money Deed of Trust," and the exemption would only be claimed on the amount of the loan that represented purchase financing.

Nonetheless, there have been instances in recent years where recordation tax refunds were sought on the basis that as long as any part of a mortgage secures purchase price, the amount of the mortgage that secures construction financing should be exempted from the recordation tax. So far, local jurisdictions have prevailed on these refund cases, but it is prudent for the statute to be amended to confirm long-standing practice and to clarify the intent that the purchase money exemption applies only to the extent that the mortgage or deed of trust secures purchase money.

Respectfully submitted,

John P. Machen

John P. (Jack) Machen
Special Chief Solicitor
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