

Department of Legislative Services
Maryland General Assembly
2000 Session

FISCAL NOTE

Senate Bill 360 (Senator Haines)

Budget and Taxation

**Recordation and Transfer Tax - Transfer from Predecessor Tenancy by the
Entireties to Limited Liability Company**

This bill provides that tenancies by the entireties are to be exempt from recordation and transfer taxes if they convert to a limited liability company (LLC).

The bill is effective July 1, 2000.

Fiscal Summary

State Effect: Potential significant decrease in inheritance and estate, and transfer tax revenues. Potential minimal increase in Annuity Bond Fund revenues.

Local Effect: Potential significant decrease in recordation and transfer tax revenues. Potential minimal increase in property tax revenues.

Small Business Effect: Potential minimal.

Analysis

Current Law: Chapter 630 of 1996 provided an exemption from recordation and transfer taxes for transfers of real property from a predecessor entity (not including a tenancy in entirety) to a LLC if: (1) the members of the LLC are identical to the partners of the converting entity; (2) each member's allocation of the profits and losses of the LLC are identical to that member's allocation of the converting entity; and (3) the instrument of writing that transfers title to real property represents the dissolution of the predecessor entity for purposes of conversion to an LLC.

Any property owned by any person or group of persons can be converted to an LLC, although the conversion of a tenancy by the entirety to an LLC is currently subject to recordation and

transfer taxes.

Background: Tenancy by the entirety is joint ownership of title by husband and wife, in which both have the right to the entire property, and upon death of one, the other has full title to the property (right of survivorship).

State 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 home buyers). The tax is collected by the clerks of the circuit court and transferred to the Comptroller of the Treasury.

State transfer tax revenues are special fund revenues dedicated for specific programs and are distributed as follows: 3% of total revenue is earmarked to defray administrative costs, and \$1 million to cover debt service expenses. The remaining revenues are approximately dedicated to the following: Program Open Space (76%), Agricultural Land Preservation Fund (17%), Heritage Conservation Fund (2%), and Rural Legacy Program (5%). Approximately 50% of Program Open Space revenues are distributed to local Program Open Space programs. Any decrease in transfer tax revenues would result in a funding decrease for these programs. The property transfer tax allocation to these programs for fiscal 2001 totals \$96,220,000.

Recordation Tax

The counties and Baltimore City are authorized by law 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 clerks of the circuit court collect the county recordation taxes in all counties except Prince George's, where they are collected by the County Director of Finance. Fees ranging from 3% to 5% of the tax collected are retained by the clerks which is credited to the State general fund. The remainder of the tax is remitted to the respective counties. Total recordation taxes collected during fiscal 1999 totaled \$180,053,530, while fees retained by the clerks totaled \$6,077,680.

A local property transfer tax may be imposed on instruments transferring title to real property. A distinction is made in the local codes between securing real property such as a mortgage. Except in Prince George's County, mortgages are not subject to the tax.

Exhibit 1 provides a schedule of local recordation and transfer tax rates for fiscal 1999. **Exhibit 2** provides a schedule of the recordation taxes collected in each county for fiscal 1999.

State Fiscal Effect:

Inheritance and Estate Taxes

Inheritance and estate taxes could significantly decrease. Under current law, it is possible that the conversion of a tenancy by the entirety to an LLC could be used to avoid inheritance and estate taxes. This occurs when a husband and wife convert the ownership of their property to an LLC. They then add their heirs as members of the LLC and each year give a certain portion of the LLC to the heirs until the heirs own 100%. In this manner, the heirs do not have to pay inheritance or estate taxes on that property upon the death of the husband and wife. This bill's exemption from the recordation and transfer tax for the conversion to an LLC would likely increase the number of persons willing to convert their tenancy by the entirety to an LLC in order to avoid inheritance and estate taxes. The Department of Legislative Service does not have any information on which to base an estimate of the number of tenancies by the entireties that would convert strictly as a result of this bill. It is possible, however, that the number could be high enough to cause a significant decrease in inheritance and estate taxes. Any such effect would depend on the value of the estate.

Transfer Taxes

An increase in the number of conversions in order to avoid inheritance and estate taxes would result in a decrease in State transfer tax revenues. As stated above, the number of tenancy by the entireties that would convert to LLCs cannot be reasonably estimated but could be significant. Therefore, the resulting decrease in State transfer taxes paid cannot be estimated but could be significant. Any decrease in transfer tax revenues would result in a funding decrease for the programs referenced above (e.g., program open space).

Annuity Bond Fund

If property owned as tenancy by the entirety is receiving a State homestead credit, conversion to an LLC would make the property ineligible for the credit. Annuity Bond Fund revenues would increase as the property tax liability would increase. It is assumed, however, that the number of tenancy by the entireties that would convert to LLCs and also have a homestead

credit is minimal.

Local Fiscal Effect: This bill could result in a potentially significant decrease in recordation and transfer tax revenues for local governments. As stated above, the number of tenancies by the entireties that would convert to LLCs cannot be reasonably estimated but could be significant. Therefore, the resulting decrease in local recordation and transfer tax cannot be estimated but could be significant.

If the property received a local homestead credit, local property tax revenues would increase. However, any such properties that would convert to a limited liability company are assumed to be minimal.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Judiciary (Administrative Office of the Courts), Department of Legislative Services

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Exhibit 1
Local Recordation and Transfer Tax Rates
FY 2000

| <u>County</u> | <u>Recordation Tax Rate per \$500 of Consideration</u> | <u>Transfer Tax Rate (Percent of Transaction Value)</u> |
|-----------------|--|---|
| Allegany | \$2.20 | 0.2% |
| Anne Arundel | 3.50 | 1.0% |
| Baltimore City | 2.75 | 1.5% |
| Baltimore | 2.50 | 1.5% |
| Calvert | 5.00 | 0.0% |
| Caroline | 3.30 | 0.5% |
| Carroll | 3.50 | 0.0% |
| Cecil | 3.30 | 0.5% |
| Charles | 5.00 | 0.0% |
| Dorchester | 3.30 | 1.0% |
| Frederick | 3.50 | 0.0% |
| Garrett | 3.50 | 1.0% |
| Harford | 3.30 | 1.0% |
| Howard | 2.50 | 1.0% |
| Kent | 3.30 | 0.5% |
| Montgomery | 2.20 | 1.0% |
| Prince George's | 2.20 | 1.4% |
| Queen Anne's | 3.30 | 0.5% |
| St. Mary's | 3.30 | 1.0% |
| Somerset | 1.65 | 0.0% |
| Talbot | 3.30 | 1.0% |
| Washington | 3.80 | 0.0% |
| Wicomico | 2.30 | 0.5% |
| Worcester | 3.30 | 0.5% |

Source: Department of Legislative Services

Exhibit 2
Distribution of Recordation Tax
FY 1999

| <u>County</u> | <u>Total Tax Collected</u> | <u>Percent Retained by Clerk of the Court</u> | <u>Fees Retained by Clerk of the Court*</u> |
|-------------------|----------------------------|---|---|
| Allegany | \$898,492 | 5.0% | \$44,925 |
| Anne Arundel | 25,320,512 | 3.0% | 759,615 |
| Baltimore City | 10,154,944 | 3.0% | 233,187 |
| Baltimore County | 18,881,706 | 3.0% | 566,451 |
| Calvert | 3,599,579 | 5.0% | 179,979 |
| Caroline | 748,745 | 5.0% | 37,437 |
| Carroll | 6,170,378 | 5.0% | 308,519 |
| Cecil | 2,175,165 | 5.0% | 108,758 |
| Charles | 7,845,412 | 5.0% | 392,271 |
| Dorchester | 929,735 | 5.0% | 46,487 |
| Frederick | 10,958,594 | 5.0% | 547,930 |
| Garrett | 1,431,230 | 5.0% | 71,562 |
| Harford | 8,056,883 | 3.0% | 241,706 |
| Howard | 11,519,878 | 5.0% | 575,994 |
| Kent | 841,068 | 5.0% | 42,053 |
| Montgomery | 34,011,374 | 3.0% | 1,020,341 |
| Prince George's** | 17,524,686 | N/A | N/A |
| Queen Anne's | 2,376,505 | 5.0% | 118,825 |
| St. Mary's | 3,539,278 | 5.0% | 176,964 |
| Somerset | 209,611 | 6.0% | 10,481 |
| Talbot | 2,749,130 | 5.0% | 137,457 |
| Washington | 3,786,856 | 5.0% | 189,343 |
| Wicomico | 1,810,552 | 5.0% | 90,528 |
| Worcester | 4,582,144 | 5.0% | 229,107 |
| TOTAL | \$180,122,457 | | \$6,129,919 |

*Net distribution before any refunds.

**The Finance Director currently collects the tax in Prince George's County and no fees are remitted to the State.

Source: Administrative Office of the Courts

