

Department of Legislative Services
Maryland General Assembly
2000 Session

FISCAL NOTE
Revised

House Bill 1187 (Delegates Finifter and Conrov)
Ways and Means

Recordation and Transfer Tax - Transfer from Real Estate Enterprises to Limited Liability Company

This bill provides that an instrument of writing that transfers title to real property from individuals conducting a "real estate enterprise" to a limited liability company (LLC) is exempt from recordation and transfer taxes.

The bill is effective July 1, 2000.

Fiscal Summary

State Effect: Potential decrease in inheritance, estate, and transfer tax revenues.

Local Effect: Potential decrease in recordation and transfer tax revenues.

Small Business Effect: Potential minimal.

Analysis

Summary: Real estate enterprise is defined as a business conducted by one or more individuals who own real property, including a sole proprietorship or a tenancy by the entirety, and are involved principally in buying, selling, leasing, or managing real property.

A transfer to an LLC is exempt from recordation and transfer tax if: (1) the transfer is for no consideration other than the issuance of membership interests in the LLC; (2) the members of the LLC are identical to the partners of the conveying real estate enterprise; (3) each member's allocation of the profits and losses of the LLC is identical to that member's allocation of the conveying real estate enterprise; (4) the transfer is part of a discontinuation

of the real property enterprise; and (5) all real property owned by the individuals and used in the conduct of business is being converted to a single LLC.

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. Predecessor entity includes a proprietorship, comprised of one or more individuals, which is involved principally in buying, selling, leasing, or managing real property.

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

recording 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 recording 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 recording 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 instruments transferring title such as a deed and certain leaseholds and instruments 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 recording and transfer tax rates for fiscal 1999. **Exhibit 2** provides a schedule of the recording taxes collected in each county for fiscal 1999.

State Fiscal Effect:

Inheritance and Estate Taxes

Inheritance and estate taxes could decrease. It is possible that the conversion of a real estate enterprise owned as 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 recording and transfer tax for the conversion to an LLC would likely increase the number of persons willing to convert 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 real estate enterprises owned as a tenancy by the entirety that would convert strictly as a result of this bill. 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 real

estate enterprises that would convert to LLCs cannot be reasonably estimated. Therefore, the resulting decrease in State transfer taxes paid cannot be estimated. Any decrease in transfer tax revenues would result in a funding decrease for the programs referenced above (e.g., program open space).

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

Additional Information

Prior Introductions: None.

Cross File: SB 360 (Senator Haines) - Budget and Taxation.

Information Source(s): Judiciary (Administrative Office of the Courts), Department of Assessments and Taxation, 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

