

Department of Legislative Services
Maryland General Assembly
2000 Session

FISCAL NOTE

Senate Bill 168 (Senator Jacobs)

Budget and Taxation

Recordation and Transfer Taxes - Exemptions - Limited Liability Companies

This bill alters the existing exemption from recordation and transfer taxes for an instrument of writing that transfers title to real property to a limited liability company (LLC) to include transfers to multiple LLCs.

The bill is effective July 1, 2000.

Fiscal Summary

State Effect: Depending on the interpretation of this bill, a decrease in special fund revenues could be either minimal or significant. Expenditures would not be affected.

Local Effect: Depending on the interpretation of this bill, a decrease in recordation and transfer tax revenues could be either minimal or significant. Expenditures would not be affected.

Small Business Effect: Minimal or potentially meaningful impact, depending on the interpretation of this bill.

Analysis

Current Law: Chapter 630 of 1996 provided an exemption from recordation and transfer taxes for transfers of real property from a predecessor entity 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.

Background: 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 37% of State transfer tax 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.

The State imposes a recordation tax rate of \$1.65 per \$500 of consideration paid for transactions involving security agreements or articles of transfer of all or substantially all of the assets of a corporation in a merger, consolidation, or other transfer. The taxes are collected by the State Department of Assessments and Taxation (SDAT) and remitted to the Comptroller. After deducting the department's administrative costs, the net proceeds are distributed to the counties based on the ratio of recordation tax collected in the prior fiscal year in each county to total recordation tax collected. During fiscal 1999, the department collected \$3,755,041 in recordation tax. Of that amount, \$93,876 was retained by the department for administrative fees. The remainder was credited to the counties.

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.

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: This bill could be interpreted in two different ways. The first interpretation, which appears to be the intention of the bill, is that an exemption from recordation and transfer tax would occur only when the ownership and profit and loss distributions of each converted LLC is identical to the ownership of the predecessor company. Under this interpretation, State transfer tax revenues could decrease depending on the number of entities that convert to more than one LLC, which is assumed to be relatively minimal. The SDAT advises that they have been interpreting the current law to include conversion to more than one LLC as long as ownership was identical. Their interpretation was based on Article 1, section 8, which states that in statutory text, the singular includes the plural and vice versa, unless such a reading is unreasonable.

The second interpretation of this bill could be that an exemption from recordation and transfer tax could occur when an existing entity converts to multiple LLCs if, in aggregate, the ownership and profit and loss distributions were the same as the predecessor entity. In other words, the new LLCs could individually have different ownership or profit and loss distributions as long as the overall ownership was the same as the predecessor entity. Under this interpretation, State transfer tax revenues could decrease substantially. At this time such a decrease cannot be reliably estimated. The loss would depend on the value and tax rate applicable to the transactions, but the loss in one single, large transaction could be significant.

Local Fiscal Effect: Under the same interpretations noted above, the effect on county recordation and transfer taxes would follow those of the State. That is, under the first interpretation, any decrease in recordation and transfer taxes could be minimal. Under the second interpretation, the decrease in these revenues could be significant. The Department of Legislative Services performed a limited survey of counties. Of those counties that responded (Baltimore, Frederick, Montgomery, and Prince George's), the first three believed that the bill would allow significant exemptions from the recordation and transfer taxes. Montgomery County indicated that their revenues could decrease by \$1.5 million a year. Frederick County indicated that their revenues could decrease by hundreds of thousands. Baltimore County stated that this bill could produce a loophole that would result in revenue loss but they were unable to determine any specific amount.

Small Business Effect: The effect of this bill on small business could be either minimal or potentially meaningful, depending on its interpretation. If the bill allows an exemption from the recordation and transfer tax when entities convert to more than one LLC only when the ownership and profit and loss distributions are identical in each new company, the impact would be minimal. It is assumed that relatively few businesses would convert to multiple LLCs.

If the bill is interpreted to allow an exemption from the recordation and transfer tax when a business converts to multiple LLCs when the ownership, in aggregate, is identical, it could encourage the establishment of shell LLCs for the sole purpose of avoiding recordation and transfer taxes. This could be potentially meaningful to small business.

Additional Information

Prior Introductions: Similar legislation was introduced during the 1998 session as HB 879 and received an unfavorable report from the Ways and Means Committee.

Cross File: None.

Information Source(s): Department of Assessments and Taxation; Judiciary (Administrative Office of the Courts); Baltimore, Frederick, Montgomery, and Prince George's counties; 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	25,313,708	3.0%	760,949
Baltimore City	10,153,660	3.0%	253,885
Baltimore County	18,881,706	3.0%	566,514
Calvert	3,599,115	5.0%	179,969
Caroline	748,745	5.0%	37,441
Carroll	6,170,378	5.0%	308,543
Cecil	2,175,165	5.0%	101,411
Charles	7,845,412	5.0%	392,271
Dorchester	929,735	5.0%	46,498
Frederick	10,953,959	5.0%	547,727
Garrett	1,431,230	5.0%	71,566
Harford	8,056,883	3.0%	241,704
Howard	11,519,878	5.0%	593,360
Kent	841,068	5.0%	42,056
Montgomery	33,999,327	3.0%	939,028
Prince George's**	17,507,366	N/A	N/A
Queen Anne's	2,376,505	5.0%	118,833
St. Mary's	3,537,320	5.0%	176,878
Somerset	186,762	6.0%	10,243
Talbot	2,748,697	5.0%	137,457
Washington	3,785,723	5.0%	193,294
Wicomico	1,810,552	5.0%	90,537
Worcester	<u>4,582,144</u>	5.0%	<u>222,591</u>
TOTAL	\$180,053,530		\$6,077,680

*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.

