HB 475

Department of Legislative Services
Maryland General Assembly
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FISCAL AND POLICY NOTE
Revised

House Bill 475 (Delegate Healey, *et al.*)

Ways and Means and Appropriations Budget and Taxation

Public School Construction Assistance Act of 2007

This bill imposes recordation and transfer taxes on the transfer of real property with a value of $1.0 million or more when the transfer is achieved through the sale of a "controlling interest" in a specified corporation, partnership, limited liability company, limited liability partnership, or other form of unincorporated business. Controlling interest is defined as more than 80% of the total value of the stock or the interest in capital and profits. The bill also requires specified amounts of local recordation taxes to be dedicated to school construction for fiscal 2008 through 2011. State transfer taxes collected under the bill are dedicated to a special fund, as provided under current law, for specified land preservation purposes.

The bill takes effect January 1, 2008.

Fiscal Summary

State Effect: Special fund revenues could increase by $7.1 million in FY 2008 reflecting the bill's January 1, 2008 effective date, with a corresponding increase in special fund expenditures including $79,200 for administrative costs. Potentially significant general fund and Transportation Trust Fund revenue increase beginning in FY 2008 from income taxes collected from nonresidents. Future year estimates reflect annualization, stable tax collections, and inflation.

($ in millions)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
GF Revenue	-	-	-	-	-
SF Revenue	7.1	14.1	14.1	14.1	14.1
SF Expenditure	7.1	14.1	14.1	14.1	14.1
Net Effect	$0	$0	$0	$0	$0

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local government revenues could increase by $24.1 million in FY 2008, and $48.2 million annually beginning in FY 2009. Local government expenditures for public school construction could increase by up to $24.1 million in FY 2008 and $48.2 million in FY 2009 through 2011. **The bill imposes a mandate on a unit of local government.**

Small Business Effect: Potential meaningful impact.

Analysis

Bill Summary: The bill • applies to transfers of controlling interests by entities which have tangible assets of which at least 80% are comprised of real property in Maryland that has an aggregate value of at least $1.0 million; • exempts certain transfers (*e.g.,* mergers and dissolutions); and • requires a report be filed with the State Department of Assessments and Taxation (SDAT) upon the transfer of a controlling interest within 30 days of the final transfer.

The tax is to be imposed on the consideration payable for the transfer of controlling interest in the real property entity reduced by the amount allocable to assets other than the real property. Consideration includes any mortgage, deed of trust, or other lien on the real property directly or beneficially owned by the real property entity and any other debt or encumbrance of the real property entity. The entity has the burden of establishing the consideration related to the real property and if it fails to do so the tax is imposed on the most recent assessed value of the property.

In addition, the bill requires Baltimore City and county governments to dedicate specified amounts of recordation tax revenue to public school construction in fiscal 2008 through 2011. The money in these special funds are intended to supplement planned school construction spending rather than supplant it. For fiscal 2008 only, the amount required is one-half of the amount specified in the bill.

The bill provides that for any fiscal year, the amount that a county is required to distribute to a special fund for school construction may not exceed the amount by which total revenue collected from recordation and transfer taxes for that fiscal year exceeds the total amount collected for fiscal 2007, after adjusting for any change in tax rates.

For fiscal 2008 through 2011, up to $5 million annually from the special fund may be appropriated in the State budget to the Maryland Park Service within the Department of Natural Resources (DNR) to pay for salaries and operating expenses.

DNR must report to the Governor and the General Assembly by October 1, 2008, the results and recommendations of a study to develop and implement a plan to fully fund the operations of the Maryland Park Service using general funds.

Current Law: Real property can be effectively transferred without payment of transfer and recordation taxes by transferring controlling interest or ownership of the entity if the property is owned by a corporation, limited liability company, or partnership.

The counties 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.

The State and counties also impose a 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 homebuyers). In some jurisdictions 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.

Background: Several other jurisdictions in the country currently tax the transfer of the controlling interest in an entity owning real property: California, Connecticut, Delaware, Illinois, Maine, New Jersey, New York, Pennsylvania, Virginia, and Washington; and the cities of Chicago, the District of Columbia, New York, and Philadelphia.

The transfer of a controlling interest is one method of transferring commercial and industrial property and results in no recordation and transfer taxes being paid. The sale of a property through the transfer of a controlling interest is not recorded in land records, and is therefore difficult to track.

The mandate that real property be assessed at its market value is jeopardized for commercial and industrial properties if these transfers are not known to the assessor. This can lead to entire classes of properties being improperly assessed, typically too low.

The State transfer tax funds several programs in the Department of Natural Resources (DNR) and the Maryland Department of Agriculture. A portion of State transfer tax revenues (3%) is earmarked to defray administrative costs within DNR, the Department of General Services, and the Maryland Department of Planning. The remainder of the revenue is dedicated to various programs including Program Open Space (POS), the Maryland Agricultural Land Preservation Fund (MALPF), Rural Legacy, and the

Heritage Conservation Fund. **Exhibit 1** shows the distribution of State transfer tax revenues after administrative costs are deducted.

Exhibit 1
Distribution of State Transfer Tax Revenues

POS	75.15%
POS Land Acquisition	1.00%
MALPF	17.05%
Rural Legacy	5.00%
Heritage Conservation Fund	1.80%
Total	**100.0%**

Of the transfer tax revenues distributed to POS, $3 million may be transferred by an appropriation in the State budget or by budget amendment to the Maryland Heritage Areas Authority Financing Fund within the Department of Housing and Community Development. Of the remaining funds, half is allocated for State acquisition and half is allocated to local governments for acquisition and development of land for recreation and open space purposes.

The Bridge to Excellence in Public Schools Act of 2002 requires local school systems to provide full-day kindergarten for all students and to make publicly funded prekindergarten available for economically disadvantaged four-year-old children. Many local school systems need to add additional classroom space in order to meet these mandates.

At the same time, State funding for public school construction declined considerably between 2003 and 2005. After averaging more than $250 million annually from fiscal 1999 to 2002, school construction funding dropped to $156.5 million in fiscal 2003, $116.5 million in fiscal 2004, and $125.9 million in fiscal 2005. In fiscal 2006, funding increased to $250.0 million; in fiscal 2007 it increased to $322.7 million. The proposed fiscal 2008 capital budget includes $388.2 million for public school construction.

State Revenues: The bill requires SDAT to collect recordation and transfer taxes when real property is transferred by means of selling a controlling interest in a business entity that owns Maryland real property.

Because this type of transaction is not currently subject to these taxes, it is difficult to estimate the exact amount of revenue that could be generated by the bill. SDAT has recently identified 27 real estate transactions in calendar 2001, 21 in 2002, 22 in 2003, 33 in 2004, 49 in 2005, and 68 in 2006 that would have resulted in the following recordation and transfer tax collections if the bill was in effect in those years:

Calendar Year	State Transfer Tax	County Transfer/Recordation Tax
2001	$3,000,000	$9,300,000
2002	3,500,000	9,100,000
2003	2,900,000	9,200,000
2004	5,300,000	17,800,000
2005	8,500,000	33,200,000
2006	11,700,000	40,100,000

Assuming a commensurate growth in the value of transactions that escape recordation and transfer taxes, based on the growth of the number of transactions that are subject to tax and those that are not subject to the tax, it is estimated that the bill could generate an additional $7.1 million in transfer tax revenues in fiscal 2008 and approximately $14.1 million annually thereafter. The fiscal 2008 estimate reflects the bill's January 1, 2008 effective date.

Exhibit 2 lists some recently identified properties that were transferred though the transfer of controlling interest, where the sale price is $100 million or more.

Exhibit 2
Properties Transferred through the Transfer of Controlling Interest with Values over $100 Million

Property	Location	Date of Transfer
Human Genone	Montgomery County	May 2006
Wyndham Inner Harbor	Baltimore City	August 2005
Cove Point LNG Facility	Calvert County	September 2002
IBM Building	Baltimore City	May 2005
Irvington Center	Montgomery County	April 2006
Capital Gateway II & IV	Montgomery County	October 2004
Wyndham Inner Harbor	Baltimore City	October 2005
Capitol Office Park	Prince George's County	March 2006
IBM Building	Baltimore City	November 1997
Human Genome	Montgomery County	May 2006
The Chase at Bethesda	Montgomery County	January 2006
Metro Park North	Montgomery County	December 2001
Bethesda Towers	Montgomery County	September 2005

Property	**Location**	**Date of Transfer**
Village Centers in Columbia	Howard County	February 2002
Executive Plaza North & South	Montgomery County	December 2003
Peppertree Farm Apartments	Montgomery County	January 2006
Marshfield Business Park	Baltimore County	June 2005

Out-year revenues would fluctuate depending on the real estate market and the number of transfers. Additionally, the imposition of taxes on these transactions may reduce the number that occurs. The actual increase in revenues depends on the number of transfers of controlling interest in real property entities and the consideration attributable to the real property.

Because the bill requires all transactions to be reported to SDAT, the Comptroller will now be able to track nonresidents involved in real property transactions. Nonresidents are required to pay income tax on the net gain from real estate transactions, but to the extent they were done through the transfer of controlling interest, the Comptroller had no mechanism with which to track these types of transactions.

It is estimated that the income tax collected from nonresidents from these sales could be significant, due to the value of properties transferred in this manner. However, because the amount of net gain from each of these transactions cannot be reliably estimated, the exact amount of income tax generated cannot be predicted.

To the extent that nonresident corporations pay more income tax, 76% of corporate income taxes are distributed to the general fund and 24% are distributed to the Transportation Trust Fund. Revenue derived from entities paying the individual income tax is distributed to the general fund.

State Expenditures: The bill requires SDAT to deduct the administrative cost of administering the program from the transfer taxes collected. Special fund expenditures by SDAT for administering the program would be approximately $79,155 in fiscal 2008 and $96,726 in fiscal 2009 to hire one charter specialist and one office secretary to assist in the collection of additional recordation and transfer taxes.

As a result, total special fund expenditures for land preservation purposes and by the Maryland Park Service could increase by $7.0 million in fiscal 2008 and by approximately $14.0 million annually thereafter. Under the bill, $5 million annually for a four-year period would be provided to the Maryland Park Service to pay for salaries and operating expenses. The remaining State revenues would be dedicated to land preservation programs, as provided under current law.

Local Fiscal Effect: It is estimated that this bill would generate approximately $24.1 million in fiscal 2008 in additional recordation and transfer taxes and $48.2 million in future years. The estimate for fiscal 2008 reflects the bill's January 1, 2008 effective date.

The bill requires the local governments to dedicate $28.2 million in fiscal 2008 and $56.4 million in fiscal 2009 through 2011 in recordation tax revenue to a special fund for public school construction as shown in **Exhibit 3.** The bill intends that these funds be used to supplement what is currently budgeted for school construction. As a result, the bill could result in more spending on school construction than might otherwise occur.

Based on the estimated revenues resulting from the bill, the counties could receive approximately $8.2 million in revenue below what is required to be dedicated to a special fund for school construction pursuant to the bill. However, the bill provides that for any fiscal year, the amount that a county is required to distribute to a special fund for school construction may not exceed the amount by which total revenue collected from recordation and transfer taxes for that fiscal year exceeds the total amount collected for fiscal 2007, after adjusting for any change in tax rates. Exhibit 3 shows the amount of revenue that could be received by each county as a result of the bill and the amount that is required to be dedicated to the special fund for school construction (the fiscal 2008 amount is equal to one-half of the amount listed below).

Small Business Effect: This bill could increase the costs of small businesses purchasing or selling real property through a sale of the controlling interest. The *2004 Statistics of U.S. Businesses* by the U.S. Census Bureau indicates that there are 96,047 firms in Maryland that have fewer than 20 employees and another 10,994 that have between 20 and 99 employees. The report indicates that the total number of Maryland firms, with employees, is 112,268.

Additional Information

Prior Introductions: This bill was introduced as HB 1294 in the 2006 session, which was not acted upon by the House Appropriations and Ways and Means committees; it is also the same as HB 1 of the 2005 session, as amended and approved by the House. No action was taken by the Senate Budget and Taxation Committee. The bill was also introduced as HB 1 in the 2004 session and was passed by the House; however, no action was taken by the Senate Budget and Taxation Committee. Similar bills were introduced as HB 19 in the 2003 session and HB 557 in the 2002 session. No action was taken by the House Ways and Means Committee on HB 19. HB 557 was passed by the House, but received an unfavorable report from the Senate Budget and Taxation Committee.

Cross File: None.

Information Source(s): State Department of Assessments and Taxation, Wicomico County, Allegany County, Montgomery County, Garrett County, Judiciary, Public School Construction Program, Department of Legislative Services

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Analysis by: Michael Sanelli

Direct Inquiries to:
(410) 946-5510
(301) 970-5510

Exhibit 3
Recordation and Transfer Tax Revenue and Distribution Required under HB 475
Fiscal 2009-2011

	Tax Revenue Dedicated for School Construction Under HB 475	Potential Recordation and Transfer Revenue Generated From HB 475
Allegany	$194,483	$166,177
Anne Arundel	5,423,188	4,633,875
Baltimore City	5,503,842	4,702,790
Baltimore	10,010,535	8,553,560
Calvert	206,249	176,230
Caroline	103,244	88,217
Carroll	572,629	489,286
Cecil	275,983	235,815
Charles	635,051	542,623
Dorchester	237,941	203,310
Frederick	1,259,692	1,076,352
Garrett	185,564	158,556
Harford	1,578,950	1,349,143
Howard	3,419,937	2,922,185
Kent	122,344	104,538
Montgomery	14,739,815	12,594,522
Prince George's	8,950,826	7,648,086
Queen Anne's	203,578	173,948
St. Mary's	660,986	564,783
Somerset	33,310	28,462
Talbot	400,653	342,340
Washington	626,786	535,561
Wicomico	316,216	270,192
Worcester	758,200	647,848
Total	**$56,420,000**	**$48,208,400**

Note: The fiscal 2008 amount is equal to one-half of the amounts show above.