



Senate Bill 436

Recordation Taxes - Exemptions

MACo Position: **OPPOSE**

Date: March 5, 2013

To: Budget and Taxation Committee

From: Andrea Mansfield

The Maryland Association of Counties (MACo) **OPPOSES** SB 436. This bill would re-open a tax loophole for the financing of commercial transactions through indemnity deeds of trust. The bill would have an unfair, sweeping, negative effect on local taxing authority and revenues.

MACo has long supported the closing of the recordation tax loophole for indemnity deeds of trust (IDOTs). An IDOT is recorded to establish a lien on the property and it typically occurs when a business entity creates an LLC to purchase property and the original business entity serves as a third party guarantor. MACo has argued that these business relationships, and the artificial “distance” they create, are for the direct purpose of avoiding taxation that would otherwise apply. The General Assembly promoted tax fairness in 2012 when it closed this loophole, effectively saying that commercial transactions should be treated and taxed the same regardless of the structural arrangements used.

The local revenue generated from closing the IDOT loophole became part of the offsets of the teacher pension costs being transferred to counties. Counties now face this bill -- which not only reopens the loophole that was closed last year; it significantly expands the exemptions as they apply to these commercial transactions.

MACo feels strongly that the closing of this unfair loophole was part of a larger policy matter and should be maintained in its current form. Any changes in the law are also premature, based on the very preliminary information gained from just a few months since the law’s effect. The Indemnity Mortgage and Deed of Trust Workgroup, which was created pursuant to last year’s bill, also reached this conclusion: *“The full impact of the new law cannot be evaluated in the few months after the law’s July 1, 2012 effective date.”*¹

¹ Report of the Indemnity Mortgage and Deed of Trust Workgroup, December 21, 2012, page 13

The bill seemingly arises from a focus on estimated revenues. Just as MACo pointed out last session, these transactions vary greatly from one year to the next, making it difficult to estimate the revenue that may result. This was evidenced by the IDOT Workgroup's in-depth efforts. Even the workgroup report showing an estimate of revenues thus far shows some jurisdictions falling below estimates, and others ahead. This mixed result comes amidst a period of historic lows in interest rates, when property owners of all sorts were aggressively engaging in voluntary refinancing to secure favorable rates.

In his follow-up letter to the Senate Budget and Taxation Committee on the IDOT Workgroup report, its chair further noted that "the estimates in the report may be flawed because large commercial transactions come through recordation at odd times and may only occur once a year or less frequently." This could result in the estimate for fiscal 2012 overstating the revenue to be received by local governments, especially given the limited amount of data available.

At a time when State aid to local governments has been reduced significantly and property assessment declines are affecting the county's largest source of revenue, the property tax, counties need to have the ability to fairly and justifiably collect local taxes. The Governor and General Assembly took the right action by closing this loophole and this policy decision should stand.

For these reasons, MACo urges the Committee to give SB 436 an **UNFAVORABLE** report.

MACo is extremely concerned with the following statutory changes and their effect on local jurisdictions.

Exempting From the Recordation Tax Transaction of Less Than \$5 Million – Based on the data examined by the IDOT Workgroup, increasing the threshold to this amount would exempt over 85% of the transactions in the two years examined. Again, this is an issue of fair tax policy. Why should commercial transactions be exempt from paying the tax when homeowners are paying the tax. Further, this will significantly impact the amount of revenue received by counties to offset teacher pension costs.

Redefines Supplemental Instrument of Writing – Based on the new definition, all IDOTs would be exempt from the tax regardless of the change in the transaction. This will allow commercial borrowers to refinance debt, with new lenders, without incurring any tax. Under these provisions, a supplemental instrument would be exempt regardless of their content or what parameters change-- the bank can change, the borrower can change, the amount can change, the underlying property secured can change— all avoiding taxation.

Applying the Recordation Tax to an Indemnity Mortgage Evidencing a Lien versus Guaranteeing the Repayment of Loan – This change would permit an exemption for a transaction that is over the threshold as long as the lien falls under. For example, under the current law a \$1.5 million transaction would be subject to the recordation tax because that is the amount that is guaranteed. With the change specified in SB 436, a \$1.5 million transaction would be exempt as long as the principal amount secured of the face of the IDOT, evidencing a lien, is less than \$1 million. MACo has been advised by several counties that their transfer desks have seen many instances of multi-million dollar transactions where the instrument stated that the lien was for less than \$1 million, even though the underlying guaranty agreements contained no such limitation.

Expansion of the Refinance Provision – The refinance exemption currently applies only to owner-occupied residential property. SB 436 would expand this exemption to commercial and non-owner occupied residential property. In effect, this means that all commercial transactions would be able to refinance and the tax would be based on the difference between the original debt and the new debt. Under current law, the tax is based on the difference between the principal balance and the new debt. As an example, if a \$5 million commercial transaction is paid down to \$2 million and the transaction is refinanced to \$4 million, no recordation tax would be paid because the refinanced amount is less than the original transaction. Meanwhile, homeowners who refinance debt on any property other than a principal residence will still be subject to the tax.