

The New IDOT Taxation Rule, Six Months On, Appears Here to Stay

Indemnity deeds of trust ("IDOTs") have historically been a popular financing method in Maryland to defer or altogether avoid payment of recordation tax on security instruments that are secured by real property. However, thanks to legislation that went into effect last year, that may change.

For many years, the typical IDOT structure often required a property owner to secure a borrower's obligations under a loan note by providing a guaranty to the lender. In turn, the guaranty was secured by an IDOT granted by the property owner. Because the property owner's guaranty of the borrower's obligations was considered a contingent liability, the IDOT was not subject to recordation tax at the time it was presented for initial recording. Note that this structure did not absolutely eliminate recordation tax because a loan default or other event that triggered the guarantor's repayment obligation would also trigger recordation tax. Nevertheless, this structure permitted borrowers to often avoid payment of recordation tax on many commercial financing transactions.

This perceived "loophole" in Maryland's recordation tax regulatory scheme was essentially closed when the State and Local Revenue and Financing Act of 2012 went into effect on July 1, 2012 (the "Act"). The Act is expected to have a significant impact on financing transactions in Maryland as such transactions will almost certainly become more expensive. Recordation taxes range from .5% to 1.2% in Maryland's 24 local jurisdictions.

The Current IDOT Recordation Tax Rules

The Act requires that recordation tax be imposed on IDOTs recorded on or after July 1, 2012. Under the Act, the following are exempt from recordation tax: (1) IDOTs securing an amount of less than \$1,000,000; (this low threshold, however, will likely be of little benefit in most commercial transactions); and (2) transactions for which the recordation tax has been previously paid (e.g., a modification upon which recordation tax was paid with the filing of the original IDOT).

Lack of uniformity in interpreting the Act's mandates has led to inconsistencies in how local jurisdictions are imposing recordation tax on similar transactions. As such, parties to financing transactions must be

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The firm's banking lawyers provide experienced counsel in connection with all aspects of commercial loans. Chaired by **Scott W. Foley**, the firm's **Banking & Financial Services Group** represents regional and community banks, credit unions, finance companies, pension funds, and other financial institutions in Maryland and throughout the Mid Atlantic.

The banking group advises financial institutions in commercial lending transactions; it also advocates for financial institutions in commercial loan workouts, restructurings, and bankruptcy proceedings. Because the group has extensive experience in the origination of loans and in workout situations, it is prepared to provide efficient representation at every stage in the commercial lending process. With decades of experience in the banking industry, Mr. Foley and the firm's other seasoned banking attorneys appreciate the potential hazards facing clients in the commercial loan process, and strive to protect lenders' interests throughout the lifecycle of the loan.

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aware of potential issues with filing IDOTs. Maryland's Office of the Attorney General has instructed local jurisdictions to interpret the Act broadly because it was "specifically enacted to provide additional revenue." In an effort to avoid confusion, some jurisdictions have publicized guidelines, including Baltimore, Howard, Prince George's, and Montgomery Counties, but these efforts have only added to the ambiguity surrounding the Act.

In the immediate future, this lack of uniformity will almost certainly impact the refinancing of deals that were structured as IDOTs prior to July 1, 2012 in order to avoid recordation tax. For example, Montgomery County appears to be taking the most lenient approach when interpreting the Act; its guidelines enumerate various IDOT modifications that will not trigger recordation tax. In Howard County, however, those same IDOT modifications are subject to the tax. Another apparent discrepancy among counties is the treatment of IDOTs that secure property located in multiple jurisdictions. Thus, despite some clarification efforts, most real estate practitioners remain mystified by the various enforcement stances in different jurisdictions.

Industry Experts Weigh In

The Maryland Department of Assessments and Taxation commissioned a group of industry experts to analyze the impact of imposing recordation tax on IDOTs. The group's findings were reported on December 21, 2012. Not surprisingly, the report indicates that local governments realized an increase in tax revenues in the latter part of 2012; in fact, the increases were greater than what was anticipated. This windfall will likely diminish the chances of having the Act repealed.

The report also concludes that the volume of commercial transactions since enactment of the Act has decreased but notes that the full impact of the new rules cannot be determined due to the short time period since enactment, as well as the generally depressed state of the economy. Finally, 25% of the business leaders surveyed by the group reported that variations in local interpretation of the law are negatively impacting the financing process.

As we embark upon a new year, additional "gray" areas regarding recordation tax on IDOTs will likely become apparent. The primary function of the IDOT is to avoid recordation tax, so it is unlikely that IDOTs over \$1,000,000 will continue to play a significant role in refinancing transactions if the current regulatory scheme remains unchanged. For loans that are close to the triggering threshold for recordation tax, one viable option to negate recordation tax may be to have borrowers contribute additional equity funds. Parties to any financial transaction that may be subject to recordation tax should seek advice from counsel before proceeding.
