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TO: All Clerks of Circuit Court
All Land Records Departments

FROM: Stuart Cordish, Courts Unit

SUBJECT: New Legislation – Taxation of IDOTs

Dear Folks:

As you know, Chap. 2 of the 2012 Special Session makes indemnity deeds of trust (IDOTs) taxable if they are for \$1 million or over. The new law affects IDOTs that are recorded on or after July 1, 2012.

A mortgage or deed of trust is generally subject to the State recordation tax, and the tax is normally imposed when the instrument is presented for recording, based on the amount of the secured debt incurred. Tax-Prop. §§12-102 & 12-104.

With a guaranty (or indemnity) deed of trust, the debt has not been incurred by the grantor of the IDOT at the time the instrument is presented. The lender agrees to make a loan to the borrower if a third party, the grantor of the IDOT, guarantees its repayment. The guarantor/grantor then executes a mortgage creating the lien on its property. But because the debt has not been incurred at the time the IDOT is recorded, no tax is collected. However, if the borrower defaults on the repayment of the loan, the debt is incurred by the grantor, and the tax becomes due. Tax-Prop. §12-105(f); 74 *Op. Atty Gen.* 281 (1989).

This bill changes the landscape for IDOTs of at least \$1 million. The new law provides that for these instruments, the debt is considered to be incurred by both the borrower and the guarantor/grantor at the same time. Because the debt is deemed incurred, these IDOTs are now taxable when presented.

The bill also provides that the tax doesn't get collected on the IDOT if the tax has already been paid on another instrument that secures the repayment of the same loan. This provision that the tax doesn't get collected on a counterpart mortgage is consistent with our interpretation of Tax-Prop. §12-108(e), which states that you don't tax a supplemental instrument.

There have been a number of questions raised as to the application of the new law, and I hope to address some of them in this memo.

Q: What is the operative date for collecting the tax?

A: The statute applies to IDOTs recorded on or after July 1. In counties where recordings are presented at more than one office, the date of recording is the date that the instrument is stamped for taxes at the first office; the first "stamp" controls.

Q: What if the IDOT is presented prior to July 1 but rejected? If it is presented again after July 1, when do we consider the IDOT to have been recorded?

A: The word has gotten out to the title companies not to wait until the last minute. If they anticipate a question as to the acceptability of the instrument, they should allow time to make corrections. The instrument will be considered recorded when the first collector accepts it and stamps it for taxes.

Q: The tax only applies to IDOTs that guarantee the repayment of loans of at least \$1 million. Even though an IDOT is for over \$1 million, does that mean that the first \$999,999 is exempt?

A: No, the bill was enacted as a revenue-generating measure for the counties and will be applied with that in mind. Once the IDOT crosses the \$1 million threshold, the entire amount is taxable.

Q: How will we know whether this is a taxable IDOT?

A: Before now, IDOTs were not required to state the amount being secured when presented for recording. Because the grantor's liability under the IDOT was contingent, no principal amount of debt had been incurred.

As of July 1, however, you will need to know the amount being secured. Therefore, you should not accept an IDOT for recording unless the following are presented:

1. A copy of the promissory note;
2. The guaranty agreement;
3. The HUD-1 or other closing statement; and
4. An IDOT affidavit (see attached)

The affidavit will not be recorded, but may be retained by your office, along with a copy of the IDOT, between audit cycles. If an existing IDOT is being amended, you will need to see a copy of the original IDOT and a copy of the original note.

There is an exception to this rule, although it is rare. Although they are called "indemnity" deeds of trust, what you normally see are "guaranty" deeds of trust, where the grantor's obligation to repay a third party's debt under the guaranty doesn't arise until the third party defaults.

A true "indemnity" deed of trust secures the grantor's own obligation, but the obligation is contingent or otherwise indeterminate. There is no debt incurred at the time the IDOT is presented, because it has not yet become fixed. These may still be recorded without the payment of tax. And they will still be taxable when the contingency occurs.

Q: Suppose an IDOT for \$500,000 is recorded without the payment of tax, and the IDOT is later amended to reflect that the loan being secured was increased by \$600,000. Do we charge tax, and on what amount?

A: Once the amount of the loan being secured reaches \$1 million, it is subject to the new law. The supplemental instrument is the trigger, but the entire amount of the loan is now taxable. This applies regardless of whether the first IDOT was recorded before or after July 1.

Under Tax-Prop. §12-108(e), you normally would not tax a supplemental instrument except on the new amount of debt secured. But, in order to claim that exemption, the debt secured by the first instrument must have been subject to the tax.

Q: Suppose an IDOT for over \$1 million is taxed and recorded. If an amendment is recorded that increases the secured loan amount, do we tax it based on just the increased debt, or tax it based on the new full amount of the loan?

A: Unless the new instrument is a refinance, you would only tax it on the additional amount of debt secured. If you have doubts about whether the new instrument is a supplemental instrument or a refinance, please refer the question to our office.

Q: What about an IDOT for more than \$1 million that is secured by real property located in Maryland *and* by property located in another state. If the amount of the loan that is allocated to Maryland property is under \$1 million, does the IDOT still get taxed?

A: Yes, once the IDOT crosses the \$1 million threshold, it becomes taxable, like any other deed of trust. And like any other deed of trust where the security is real property located both within Maryland and without, it is subject to allocation. You would collect the tax attributable to the Maryland real property.

Q: Could you have two separate loans for \$750,000, each involving an IDOT from the same grantor, secured by the same property and presented at or about the same time, and record each IDOT without the payment of the tax?

A: Possible but unlikely. If the transactions are truly independent of each other, then technically each gets recorded without the payment of recordation tax. Odds are you won't see that very often.

Q: Tax Avoidance. What happens if the grantor tries to avoid the tax on a single loan of \$1 million or more, by recording multiple IDOTs, all of which are under \$1 million? How would we know this is occurring?

A: This statute was enacted specifically to provide additional revenue for the counties, and it will be applied as broadly as the law permits. If a single taxable transaction is disguised, by breaking it down into multiple steps to avoid payment of the tax, we will consider "collapsing" those steps back into one taxable transaction. The "step transaction" doctrine, approved by the Court of Appeals in *Read v. Supervisor of Assessments*, 354 Md. 383 (1999), permits the collector to look at the true substance of a transaction and disregard the form.

Therefore, the party who submits the IDOT for recording must be prepared to demonstrate the true nature of the transaction by presenting the guaranty, the promissory note, and the HUD-1 or closing statement, along with the affidavit as to the total principal amount of the debt being secured.

If, for example, you see a \$2 million promissory note, but the IDOT secures only \$750,000, that should raise a red flag, and you can be on the lookout for the rest of the "steps." Granted, it is more difficult to apply the doctrine as the steps are spaced farther apart, but if you have doubts about the taxability of an instrument, please contact our office.

I expect additional questions to arise. We'll blow up those bridges as we come to them.

attachment

AFFIDAVIT FOR INDEMNITY DEED OF TRUST

(to accompany IDOT presented to the Clerk of the Court)

For Clerk's Use Only – NOT FOR RECORDING

By signing below, I hereby certify, affirm, and declare, under penalty of perjury, that the accompanying Indemnity Deed of Trust meets the following requirements for exclusion from Recordation Tax:

- The grantor of the IDOT is a separate and distinct entity from the maker of the note, and is not obligated under the note.
- The grantor of the IDOT has signed a guaranty of the note.
- The IDOT secures only the guaranty.
- The grantor of the IDOT is not primarily liable for the indebtedness.
- The proceeds of the loan have not been used to acquire the property secured by the IDOT.
- The amount of the note referenced in the IDOT is \$ _____.
- The amount of the secured debt of the IDOT or the amended and restated IDOT is \$ _____.
- The parcel identification number is _____.

Signed this _____ day of _____

By _____

Print Name _____

Signer is (please check one choice below):

Lender's Attorney _____

Settlement Attorney _____

Party to the IDOT _____