

Avoiding MD Recordation Tax On Loan Transactions

By

Owners of commercial properties in many counties in Maryland have two choices when it comes to refinancing. One option costs you dearly, the other - when executed properly - creates a considerable savings. Here's how it all works:

Scenario 1. Owner, LLC ("Owner") has substantial assets and owns a commercial office building valued at \$25 million that's located in Rockville, Maryland. A local bank has agreed to lend Owner \$15 million to refinance the first mortgage loan on the property. Upon recording the new \$15 million mortgage, Owner will pay a recordation tax of \$148,450 to the Clerk of the Circuit Court of Montgomery County.

Scenario 2. The facts are the same, but there's a totally different loan structure. The principals of Owner form a new LLC called Borrower, LLC, which has no assets and whose sole member is Owner, LLC. Instead of lending the \$15 million to Owner, the bank lends it to Borrower, LLC.

Why would the bank lend \$15 million to a shell company with no assets? For two reasons. First, the loan is personally guaranteed by Owner, which has substantial assets. Second, Owner will give the bank a first "indemnity" mortgage on its office building as collateral security for Owner's personal guarantee. The net of all that is that the bank ends up in the very same position as under Scenario 1. The difference is that upon recording the new \$15 million mortgage, Owner will pay a recordation tax of ZERO. What's the net savings to Owner? A whopping \$148,450; a nice loophole to say the least!

Why ZERO recordation tax? The answer is that the mortgage under Scenario 2 is an "indemnity" mortgage which is given to secure Owner's personal guarantee of the loan. Currently, in many counties in Maryland, there is no recordation tax charged or collected at the time of the recordation of the "indemnity" mortgage.

End Result. Owner received the loan to refinance its office building, but paid ZERO recordation tax. The bank came away with what it wanted—a very nice loan, a personal guarantee by Owner and a first priority lien on the Owner's office building.

WARNING. Not all counties in Maryland exempt indemnity mortgages from the recordation tax. If you are involved in a similar transaction, you need to check with the county clerk of court or county transfer office to find out if your transaction will be exempt from the recordation tax. If not, there is little reason for the re-structure.