PALEY ROTHMAN
ATTORNEYS AT LAW

MD Law Expands Recordation & Transfer Tax Exemptions

By Katherine Palumbo

Recordation and transfer taxes in Maryland are among the highest in the region, and can be prohibitively expensive to someone wanting to transfer real property - during life or at death, outright or in trust - as part of his or her estate planning. A new state law (effective July 1, 2011) that expands existing recordation and transfer tax exemptions should lower the transactional costs for many types of estate planning conveyances. It will also close a loophole that has recently been used by one Maryland county (and is under consideration by other counties in the state) to impose recordation and transfer taxes on certain transfers of real property from an estate.

Before looking at the new statutory framework, it may be helpful to review the recordation and transfer tax exemption statutes in place prior to the effective date of the new law. Sections 12-108 and 13-207(a) of the Tax-Property ("TP") Article of the Annotated Code of Maryland ("Code") do not contain express exemptions for conveyances of real property by an estate, or to or from estate planning trusts. Section 9-105(c) of the Estates & Trusts ("ET") Article provides some safeguards by prohibiting a state or local excise tax from being imposed on a personal representative's deed distributing real property "in kind" from an estate to the beneficiaries if the transfer is made "without consideration." No comparable provision exists for conveyances by the trustee of a probate-avoidance type trust upon the death of the trust's grantor, but it has been the practice in most Maryland counties not to impose recordation or transfer taxes on conveyances by a trust to the beneficiaries upon the death of the trust grantor.

The "status quo" was disrupted in June 2009 when Montgomery County began to impose a recordation tax on transfers from an estate or trust to the respective beneficiaries if the transferred property was encumbered by a mortgage or deed of trust, with the tax being levied on the outstanding principal balance of the encumbrance. The county's new position was consistent with the express language of the recordation and transfer tax statutes, which define taxable "consideration" to include the outstanding balance of any mortgage or deed of trust encumbering the transferred property. Nevertheless, the new tax drew protests from estates & trusts and real estate attorneys since the county's new position deviated from long-standing Maryland practice. The county also encountered strong opposition when it refused to extend existing exemptions under TP Sections 12-108(c) and 13-207(a)(2), which provide that "consideration" does not include the outstanding balance of any mortgage or deed of trust encumbering the transferred property where the transfer is made to certain enumerated classes of transferees bearing a close familial or other legal relationship with the transferor ("exempt transferees").

The new law makes several significant changes:

While property transferred from an estate "without consideration" will continue to be exempt from state and local excise taxes (including recordation and transfer taxes) under ET Section 9-105(c), the term "consideration" will now expressly exclude the amount of any mortgage or deed of trust that encumbers the transferred property.

A new exemption from recordation and transfer taxes will apply to property transferred to a trust if the transfer is without "consideration," which for this purpose, does not include the amount of any mortgage or deed of trust encumbering the transferred property. This exception will apply to property conveyed to revocable, probate-avoidance trusts, as well as irrevocable trusts (including, for example, a qualified personal residence trust, also known as a QPRT, and an intentionally defective grantor trust or IDGT). The new exemption will not apply to statutory business trusts or real estate investment trusts.

Another new exemption from recordation and transfer taxes will be added for transfers made from a trust without consideration. Here again consideration is defined to exclude the amount of any mortgage or deed of trust encumbering the transferred property), if (i) the transfer is made to a beneficiary who would be an exempt transferee if the grantor of the trust had made the transfer directly to that transferee, or (ii) if the transfer is made during the lifetime of the trust's grantor and the trustee originally acquired the property for “adequate consideration,” which might be the case in certain estate planning transfers. As mentioned above, the new exemption does not apply to statutory business trusts or real estate investment trusts.

This new law brings a long-awaited and much-needed change that will provide greater flexibility for estate plans that include Maryland real property.

 | 4800 Hampden Lane, 6th Floor, Bethesda, MD 20814-2930 | 301-656-7603 | 301-654-7354 fax