

Recordation Exemptions for Commercial Refinancings

By Katherine Palumbo

Several recent changes to Maryland's recordation tax exemption law (§12-108 of the Tax-Property Article of the Annotated Code of Maryland), which took effect on July 1, 2013, should result in lower transactional costs in conjunction with the refinancing of commercial loans secured by a mortgage or deed of trust (for convenience, both will be referred to as "deed of trust") on commercial property.

The biggest impact will be felt in the refinancing of indemnity deeds of trust, also known as "IDOTs," that were put into place prior to July 1, 2012 (the date when IDOTs first became subject to recordation tax in Maryland). Two of the exemptions affected by the amendments are those applicable to certain refinancings under §12-108(g) ("refinancing exemption") and to certain supplemental instruments of writing under §12-108(e) ("supplemental instrument exemption").

Prior to July 1, 2013, the refinancing exemption was extremely narrow, applying only to residential refinancing by an individual of his or her principal residence, where the individual was the original mortgagor. Consequently, this exemption could not be used in connection with the refinancing of a loan made to any person other than an individual (which would include, without limitation, a limited liability company, limited partnership or corporation) or in conjunction with the refinancing of a loan secured by a deed of trust on any property other than a principal residence (which would include, without limitation, commercial property). As amended, the refinancing exemption is now extended to apply to refinancing of commercial loans and refinancing by borrowers other than individuals, so long as the borrower is the original mortgagor. As with the previous law, the refinancing exemption only applies to the extent of the unpaid outstanding principal balance of the original loan, so any increase in principal under the new loan will be subject to recordation tax. The refinancing exemption will also now be available to IDOTs, regardless of whether recordation tax was paid on the original IDOT.

Under the old law, commercial borrowers who were ineligible for the refinancing exemption were sometimes able to achieve a similar result by structuring the transaction as the purchase of the original loan by the new lender followed by modification to the terms of the original loan to reflect the terms of the new loan. The modified deed of trust would be recorded as a supplemental instrument subject to the supplemental instrument exemption. A supplemental instrument under previous law was defined under §12-101(l) as an instrument in writing that "confirms, corrects, modifies or supplements a previously recorded instrument of writing" and such instrument is not subject to recordation tax to the extent that there was no increase in the "debt secured."

Use of the supplemental instrument exemption did have some drawbacks, such as the uncertainty of how extensive the modifications could be to the underlying instrument before it was treated as a new instrument subject to recordation tax. Until recently, a great deal of leeway had been given in this respect, so long as the identity of the borrower remained the same. As a result, it became fairly routine for the modified instrument to be a complete amendment and restatement of the original instrument of writing. In recent years, with many jurisdictions providing higher scrutiny to such transactions, the likelihood of the exemption applying became less certain. For another thing, IDOTs under previous law were not considered to be supplemental instruments because recordation tax had not been paid with respect to the prior recorded instrument of writing.

The new law expands the supplemental instruments exemption by modifying the definition of supplemental instrument of writing under §12-101(l) to include "instruments which amend and restate a prior recorded instrument in writing" and also by specifying that an instrument would be considered supplemental regardless of whether recordation tax had been paid on the previously-recorded instrument of writing. In addition, under §12-105(f)(7) – which applied recordation tax to most IDOTs after July 1, 2012 – an IDOT can still be considered a supplemental instrument of writing, to the extent of the unpaid outstanding principal balance, whether or not recordation tax was paid on the prior instrument in writing. As with the refinancing exemption, any "new money" advanced in connection with the IDOT modification

is subject to recordation tax.

Section 12-105(f)(7) was also amended to exclude from recordation tax at the time of recording IDOTs that secure the guaranty of a loan, or series of loans that are part of the same transaction, if such loan or series of loans is under \$3 million (increased from \$1 million).

To illustrate the savings that may be available to refinancing some IDOTs, assume an IDOT secures the guaranty of a loan made prior to July 1, 2012 in the original principal amount of \$7 million - and at the time of refinancing, the unpaid outstanding principal balance is \$3.5 million. Assume further that the principal amount of the new loan is also \$3.5 million. Prior to July 1, 2013, since neither the refinancing exemption nor the supplemental instrument exemption was available, the entire principal balance of the new loan would be subject to recordation tax. If the applicable recordation tax rate at the time is \$10/\$1,000, this would result in a recordation tax in the amount of \$35,000. For the same transaction, occurring after July 1, 2013, there would be no recordation tax due, since no additional principal has been advanced.