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Lenders Beware in Maryland: The Changing Nature of IDOT Recordation Tax Collection

The Indemnity Deed of Trust (IDOT) structure often is used in Maryland to defer Maryland recordation taxes, which would otherwise be due by a borrower under a typical deed of trust at the time of recordation. There are two obligor parties to a loan structured as an IDOT: the Debtor (e.g., borrower) who is directly liable under the promissory note, and the Grantor who will become liable for payment of the loan upon a default by Debtor pursuant to a payment guaranty. The Grantor owns the underlying property and grants that property to a lender as security under an IDOT to secure repayment of a payment guaranty, which – in turn – guarantees payment of a promissory note made by the Debtor. The basis for the deferral of the recordation tax is Maryland Code, Tax-Property Article, §12-105(f)(1), stating that the recordation tax applies only to the principal amount of the debt incurred at the time of recording. As long as the note is paid in accordance with its terms, the Grantor's obligation to pay the debt under the payment guaranty is not incurred, the IDOT is not deemed to be securing a direct obligation, and no recordation tax is due. However, as soon as the Grantor becomes directly liable for the debt, the obligation for the Grantor to pay the recordation tax is triggered.

In accordance with §12-105(f)(2), on or before seven days after any additional debt is incurred,¹ the Grantor is required to file a statement of additional debt incurred under oath with the clerk of circuit court and pay the recordation tax. Since this self-reporting generally does not occur in practice, the Attorney General has instructed all clerks to notify local taxing authorities when an IDOT foreclosure action is docketed so that the recordation tax can be collected. Once the debt under a payment guaranty is incurred as a result of a default, the tax remains due until paid even if the default is later cured.

It has traditionally been viewed in Maryland that, pursuant to *74 Opinion of the Attorney General 281*, the Grantor is the party obligated to pay the recordation tax once the tax is triggered. The opinion provides that “[t]he responsibility for paying the recordation tax on an indemnity mortgage is imposed on the guarantor; the guarantor is the person who has ‘incurred’ the debt that is secured by the indemnity mortgage.” This finding is based on the language of Maryland Code, Tax-Property Article, §12-105(f)(2), which states that when additional recordation taxes are due because additional debt becomes due, such taxes are to be paid by the Debtor (e.g., the Grantor who now has become a direct obligor). In practice, the recordation tax is rarely collected from the Grantor either because the Grantor does not have the money to pay the tax or is not incentivized to pay the tax on a property that is in default and could possibly be transferred to the lender. Recently, certain counties in Maryland – including Howard County and, more recently, Montgomery County – are disregarding the traditional reading of the Maryland Attorney General's opinion and are asserting that in order to record a trustee's deed or a deed in lieu of foreclosure, the recordation tax must be paid. This essentially makes the deferred recording tax the

¹ The date of incurrence of the debt by Grantor will depend upon the terms of the payment guaranty; such debt may be incurred immediately upon default or, if so provided in the payment guaranty, after default and demand by the lender.

obligation of the property rather than the Grantor and shifts the burden of paying the tax from the Grantor to the foreclosing lender.

We are aware of one instance where Montgomery County made demand on a receiver appointed to stabilize and manage a property to pay the deferred recordation tax out of property funds. In that instance, Montgomery County relied on footnote 6 of the Maryland Attorney General's opinion, which provides: "the Attorney General recognizes that a reasonable argument can be made [under principles of equity] that would entitle the County to a lien." Howard County and Montgomery County are, therefore, construing the deferred recordation tax as a tax (or equitable lien) on the property, in lieu of a tax imposed for the privilege of recording an instrument that is personal to the Grantor.

Given that the recordation tax in Howard County and Montgomery County is currently .50% and .69% of the secured amount, respectively, the potential obligation to a foreclosing lender is meaningful. Several other counties in Maryland charge 1% to 1.2% of the secured amount for recordation taxes. While we are currently only aware of Howard County and Montgomery County pursuing the property and lender for deferred IDOT recordation taxes, other counties could certainly follow suit in an effort to increase revenue and plug budget gaps.

Since a lender's agreement to use an IDOT structure is purely an accommodation to a borrower and there exists potential liability to the lender with respect to deferred recordation taxes at the time of a foreclosure, some lenders for Maryland properties are requiring additional collateral as consideration for allowing a borrower to utilize an IDOT structure. Many lenders include IDOT tax liability as an additional recourse carve-out or require a borrower to post cash or a letter of credit to secure payment of the potential tax liability.



If you have any questions regarding this Legal Alert, please feel free to contact the attorneys listed below or the Sutherland attorney with whom you regularly work.

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