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Maryland Governor Signs Bill Taxing IDOTs

On May 22, 2012, the Maryland Governor signed into law a tax bill that will change the manner in which many commercial real estate transactions are structured in Maryland. Pursuant to the new law, which takes effect July 1, 2012, indemnity deeds of trust (IDOTs) securing a debt obligation in excess of \$1,000,000 will be subject to recordation tax at the time of recordation in the same manner as conventional deeds of trust. This major change in the tax law will have a significant impact on the cost of financing commercial real estate in Maryland. For example, in Montgomery County, Maryland, the act will increase the cost to enter into a commercial real estate transaction with a secured debt obligation over \$1,000,000 by approximately one percent (1%).

In Maryland, IDOTs have been used to defer the payment of recordation taxes that otherwise would have been due and payable had a lender and a borrower entered into a financing arrangement secured by a conventional deed of trust. In an IDOT structure, there are two obligor parties to a loan: a borrower, who is directly liable under the promissory note, and a guarantor, who guarantees the payment obligation of the borrower and secures its guaranty with a deed of trust on the secured property. Pursuant to the IDOT guaranty, the guarantor becomes liable for payment of the loan upon the borrower's default. Based on a long-standing reading of the Maryland Code by the Maryland State Attorney General, an IDOT was found to secure a contingent guaranty obligation rather than a direct debt obligation. Therefore, in most Maryland counties, the obligation to pay recordation tax on a recorded IDOT was deferred until such time, if ever, that the contingent debt payment obligation under the guaranty was triggered (e.g., upon a borrower default), at which time the borrower became obligated to pay the deferred tax. Pursuant to the new law, the recordation tax applies to an IDOT as if the guarantor were primarily liable for the guaranteed loan.

While the law is silent on the retroactive effect on existing IDOTs, a number of sources within the commercial real estate community have concluded that the act will apply only prospectively. The legislation also does not address whether the recordation tax will apply to post-July 1, 2012 modifications to or assignments of existing IDOTs (i.e., those recorded prior to July 1, 2012). There is no consensus yet regarding such changes to existing IDOTs nor is it clear that all recording offices will treat the issue consistently.

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