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Maryland Imposes Tax on Transfers of Controlling Interests in Real Property Entities

By Thomas R. Petty

Subject to certain exemptions, most transfers of real property in the State of Maryland are subject to payment of state and county transfer and recordation taxes at rates that range, in the aggregate, from 1.16% to 3.0% of the amount of the consideration paid. In order to avoid such taxes, many commercial transactions have been structured as a transfer of a controlling interest in the entity owning real property (which has not been taxable), rather than as a transfer of the underlying real property asset. Soon, that option will be less viable.

As a result of legislation enacted in 2007, effective July 1, 2008, transfers of a controlling interest in a real property entity will be subject to recordation and transfer taxes in the State of Maryland in the same manner that transfers of real property are taxed. Parties should consider these tax law changes in structuring new and pending transactions.

Three threshold questions are relevant in determining if the new taxes are applicable—

First, is the entity a real property entity? — A “real property entity” is defined in the statute as a corporation, limited liability company, partnership or other form of legal entity that owns real property which (1) constitutes at least 80% of the total value of such entity’s assets, and (2) has an aggregate value of at least \$1,000,000; for purposes of this determination, the value of the real property is not reduced by the amount of any outstanding debt.

Second, is the interest a controlling interest? — A “controlling interest” is defined in the statute as “more than 80%” of the total value of stock or the total interest in capital and profits of the entity.

Third, is the transaction a “transfer” subject to tax? — One or a series of transfers are taxable if (1) the transfer is completed within a period of 12 months, or (2) the transfer is made as part of an intentional plan or program of transfer (e.g., if transfers of more than 80% of the value of an entity are spread out over a period of more than 12 months pursuant to a contract of sale, the transfers would be taxable as part of an “intentional plan” of transfer).

If the transaction is taxable, two remaining questions become relevant –

How are the taxes calculated? – The taxes are based on (1) the purchase price for the controlling interest(s), plus (2) the amount of any debt on the real property, less (3) the value of any personal property and any real property not located in Maryland that is owned by the entity.

Is there a tax exemption? – Transfers of controlling interests in real property entities are subject to all of the exemptions applicable to transfers of real property. In addition, transfers of controlling interests in real property entities are entitled to certain exemptions that are not applicable to transfers of real property; for instance, transfers of controlling interests among related entities are exempt from recordation and transfer taxes.

The real property entity – not the transferor or the transferee – is ultimately responsible for payment of recordation and transfer taxes. The real property entity is obligated to report to state authorities any taxable transfer within 30 days after the transfer.

Transfers of controlling interests in real property entities are not subject to recordation or transfer taxes in the neighboring Commonwealth of Virginia. In the District of Columbia, transfers of controlling interests in real property entities have long been subject to recordation tax.

The following chart is a brief summary of the applicable recordation and tax rates in the District of Columbia, Maryland and Virginia. In each jurisdiction, various exemptions apply and transaction structures are permitted which can reduce the amount of taxes payable. For information, please contact Thomas Petty at tpetty@andersonkill.com, or (202) 416-6541.

REAL PROPERTY RECORDATION AND TRANSFER TAXES

DISTRICT OF COLUMBIA

Deeds	transfer tax – 1.45% tax rate; recordation tax – 1.45% tax rate.
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Deeds of Trust, Mortgages	transfer tax – none; recordation tax – 1.45% tax rate.
Leases	a lease for a term of 30 years or more (including renewal terms) is subject to the same recordation and transfer taxes that are applicable to a deed.
Economic Interest in Real Property Entity	a transfer, in one or more transactions within any 12 month period, of more than 50% of an economic interest in any legal entity which (1) derives more than 50% of its gross receipts from the ownership of real property in the District, <u>or</u> (2) owns real property in the District that constitutes at least 80% of the total value of such entity's tangible assets, is subject to recordation tax at a rate of 2.2%.

MARYLAND

Deeds	state transfer tax – 0.50% tax rate; county transfer tax – 0.00% to 1.50% (rate varies from county to county); county recordation tax – 0.50% to 1.20% (rate varies from county to county).
Deeds of Trust, Mortgages	state transfer tax – none; county transfer tax – 0.00% to 1.50% (rate varies from county to county); county recordation tax – 0.50% to 1.20% (rate varies from county to county).
Leases	a lease for a term of more than 7 years must be recorded, and is subject to the same recordation and transfer taxes that are applicable to a deed.
Economic Interest in Real Property Entity	a transfer, in one or more transactions within any 12 month period, of more than 80% of an economic interest in any legal entity that owns real property which (1) constitutes at least 80% of the total value of such entity's assets, <i>and</i> (2) has an aggregate value of at least \$1,000,000, is subject to the same recordation and transfer taxes that are applicable to a deed.

VIRGINIA

Deeds	state recordation tax – 0.25% tax rate; county recordation tax – 0.0833% tax rate (one-third of the state recordation tax); state grantor's tax – 0.50% tax rate.
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Deeds of Trust, Mortgages	state recordation tax – 0.25% on the first \$10 million of debt secured; 0.22% on the next \$10 million; 0.19% on the next \$10 million, 0.16% on the next \$10 million, and 0.13% on all debt in excess of \$40 million; county recordation tax – one-third of the state recordation tax; state grantor's tax – none.
Leases	state recordation tax – 0.25% tax rate; county recordation tax – 0.0833% tax rate (one-third of the state recordation tax); state grantor's tax – none.
Economic Interest in Real Property Entity	N/A

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