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Subtitle 13 RECORDATION AND TRANSFER [TAX] TAXES

18.13.02 Transfers of Controlling Interests

Authority: Tax-Property Article, §§12-102, 12-103, 12-112, 12-117, and 13-202, Annotated Code of Maryland

Notice of Proposed Action

[08-118-P]

The Director of Assessments and Taxation proposes to adopt new Regulations **.01— .12** under a new chapter, **COMAR 18.13.02 Transfers of Controlling Interests**.

Statement of Purpose

The purpose of this action is to comply with the legislative mandate in Ch. 3, Acts of 2007—Special Session, that the Department adopt regulations to administer new statutes generally imposing recordation and transfer tax on transfers of a controlling interest in real property.

Comparison to Federal Standards

There is no corresponding federal standard to this proposed action.

Estimate of Economic Impact

I. Summary of Economic Impact. State recordation and transfer taxes would increase in fiscal 2009 approximately \$14,100,000 annually while the potential increase in local recordation and transfer taxes in fiscal 2009 would be approximately \$48,208,400.

II. Types of Economic Impact.	Revenue (R+/R-) Expenditure (E+/E-)	Magnitude
A. On issuing agency:	(R+)	\$14,100,000 annually
B. On other State agencies:		
(1) Program Open Space	(R+)	\$3,400,000 annually
(2) Comptroller	(R+)	Cannot be reliably estimated

C. On local governments:	(R+)	\$48,200,000 annually
	Benefit (+) Cost (-)	Magnitude
D. On regulated industries or trade groups:	(-)	\$62,300,000 annually
E. On other industries or trade groups:	NONE	
F. Direct and indirect effects on public:	NONE	

III. Assumptions. (Identified by Impact Letter and Number from Section II.)

A. Assuming commensurate growth in the value of the transactions that escape taxation, and based on the growth of the number of transactions that are subject to the tax and those that are not, beginning in fiscal year 2009, special fund revenues would increase by this approximation.

B(1). Assumes State aid under this program, beginning in fiscal year 2009.

B(2). The Comptroller will be able to track nonresidents involved in real property transactions to collect income tax on net gains.

C. Assuming commensurate growth in the value of the transactions that escape taxation, and based on the growth of the number of transactions that are subject to the tax and those that are not, beginning in fiscal year 2009 local recordation and transfer taxes would increase by this approximation.

D. Those regulated would pay more State and local recordation and transfer taxes in fiscal 2009. The amount stated assumes commensurate growth in the value of the transactions that escape taxation, and is based on the growth of the number of transactions that are subject to the tax.

Economic Impact on Small Businesses

The proposed action has minimal or no economic impact on small businesses.

Impact on Individuals with Disabilities

The proposed action has no impact on individuals with disabilities.

Opportunity for Public Comment

Comments may be sent to Robert E. Young, Assistant Director, Department of Assessments and Taxation, 301 W. Preston Street, 8th Floor, Baltimore, MD 21201, or call 410-767-1184, or email to ryoung@dat.state.md.us, or fax to 410-333-5873. Comments will be accepted through May 27, 2008. A public hearing has not been scheduled.

.01 Scope.

The regulations in this chapter apply to both recordation and transfer taxes administered by the Department under Tax-Property Article, Titles 12 and 13, Annotated Code of Maryland, to the extent allowed by law.

.02 Definitions.

A. In this chapter, the following terms have the meanings indicated.

B. Terms Defined.

- (1) *“Beneficially owned by a real property entity” means the entity holds:*
- (a) *An ownership interest in another entity that owns the real property directly;*
 - (b) *An interest in another entity or entities that, through a series of ownership tiers, ultimately reaches an entity that owns the real property directly; or*
 - (c) *A beneficial interest in a trust that directly owns the real property or, through a series of trusts or other entities, ultimately reaches an entity that owns the real property directly.*
- (2) *“Controlling interest” has the meaning stated in Tax-Property Article, §12-117, Annotated Code of Maryland.*
- (3) *“Controlling interest percentage standard” means the more-than-80-percent standard in the definition of “controlling interest” as stated in Tax-Property Article, §12-117, Annotated Code of Maryland.*
- (4) *“Directly owned by a real property entity” means the entity holds an interest in real property transferable by an instrument of writing.*
- (5) *Final Transfer.*
- (a) *“Final transfer” has the meaning stated in Tax-Property Article, §12-117, Annotated Code of Maryland.*
 - (b) *“Final transfer” does not include any transfers or steps in a transfer occurring before July 1, 2008.*
- (6) *“Instrument of writing” has the meaning stated in Tax-Property Article, §12-101, Annotated Code of Maryland.*
- (7) *“Plan of transfer” has the meaning stated in Tax-Property Article, §12-117, Annotated Code of Maryland, and includes:*
- (a) *Transfers of interests in a real property entity to multiple grantees under one or more agreements if the totality of the transfers to the separate grantees meets the controlling interest percentage standard in any 12-month period, unless the real property entity can establish to the Department's satisfaction that the transfers were part of entirely separate, distinct, and unrelated contracts or agreements; and*
 - (b) *Transfers of interests in a real property entity that, if done by an instrument of writing for real property directly, would be taxable under Tax-Property Article, Titles 12 and 13, Annotated Code of Maryland, including articles of consolidation, articles of merger, and articles of transfer, as those terms are defined in Tax-Property Article, §12-101, Annotated Code of Maryland, whereby either:*
 - (i) *The real property entity ceases to exist; or*
 - (ii) *The parties holding the controlling interest in the real property entity and their respective allocation of distributions, profits, and losses are not identical at the beginning and end of the transaction.*
- (8) *“Real property” has the meaning stated in Tax-Property Article, §12-117, Annotated Code of Maryland.*
- (9) *“Real property entity” has the meaning stated in Tax-Property Article, §12-117, Annotated Code of Maryland.*
- (10) *“Step transaction doctrine” means the legal doctrine that:*
- (a) *Looks to the substance of a transaction over its form to determine that steps have been taken to achieve tax avoidance;*
 - (b) *Amalgamates or collapses the separate transfers or steps into one transaction where they are actually component parts of a single transaction; and*

(c) Is based on the application of three separate tests as defined and applied in Read v. Supervisor of Assessments, 354 Md. 383, 731 A.2d 868 (1999), which are the:

(i) End result test;

(ii) Interdependence test; and

(iii) Binding commitment test.

.03 Valuation of Controlling Interests.

The valuation of a controlling interest:

A. Is not determined solely by the number of shares or other units of ownership interest and the par value or other value assigned to those interests by a real property entity; and

B. Will consider the value of the rights and benefits associated with the majority ownership of the controlling interest being transferred as reflected in the transactional documents and any other evidence considered relevant by the Department.

.04 Determination of Completed Transfer.

A. A transfer of controlling interest is considered complete when the controlling interest percentage standard is met within any 12-month period, regardless of whether other transfers may be planned or have taken place outside of the 12-month period.

B. If a final transfer of controlling interest is accomplished through multiple steps that would be considered one transaction under the step transaction doctrine, then that one transaction, including all multiple steps that make up that one transaction, is considered effective and complete upon the earlier of the date when:

(1) The last step has occurred; or

(2) The interest transferred in the multiple steps meets the controlling interest percentage standard, regardless of the fact that other steps may be planned for the future.

.05 Reports of Transfers.

A. A real property entity shall file the report required by Tax-Property Article, §12-117(d), Annotated Code of Maryland:

(1) On a form required by the Department; and

(2) Under the signed oath of an individual who has authority to bind the real property entity.

B. Reports of transfers of controlling interest shall be filed with the Department within 30 days of the final transfer, regardless of the application of any exemption.

C. If there is a transfer of an interest in an entity where the value of the real property interest held by that entity is between 70 percent and 80 percent of the value of its assets, that entity may file a report with the Department to reflect that the transfer has occurred without the payment of recordation or transfer taxes.

D. If there is a transfer of an interest in a real property entity and its value is between 50 percent and the controlling interest percentage standard, that entity may file a report with the Department to reflect that the transfer has occurred without the payment of recordation or transfer taxes.

E. The fact that the Department accepts a permissive filing under this regulation without the payment of recordation or transfer taxes does not estop it from subsequently determining that the transfer reflected in that filing was taxable.

F. The filing of a report of transfer under Tax-Property Article, §12-117, Annotated Code of Maryland, or this regulation does not create a requirement to qualify or register with the Department under the Corporations and Associations Article, Annotated Code of Maryland, unless otherwise required by law.

.06 Determination of Consideration.

A. The Department determines the amount of consideration payable for the transfer of a controlling interest and imposes the corresponding tax based upon:

(1) The report referenced in Regulation .05 of this chapter; and

(2) Any other information secured by the Department.

B. Consideration payable for the transfer of a controlling interest includes all consideration payable under a plan of transfer, regardless of whether it has been totally paid at the time of the final transfer.

C. If the Department determines that there has been a failure to establish the consideration attributable to the transfer of the controlling interest, the Department will impose the tax upon that proportion of the fair market value of the real property directly or beneficially owned by the real property entity that equals the same proportion of the controlling interest being transferred.

D. The fair market value referenced in §C of this regulation is the value of the real property determined by the Department as of the date of finality immediately preceding the final transfer.

.07 Applicability of Exemptions.

A. The transfer of a controlling interest is exempt from recordation tax only to the extent that a specific transfer under a plan of transfer meets the criteria for an exemption set forth in Tax-Property Article, §12-117(c), Annotated Code of Maryland.

B. The transfer of a controlling interest is exempt from transfer tax only to the extent that a specific transfer under a plan of transfer meets the criteria for an exemption set forth in Tax-Property Article, §13-103(c), Annotated Code of Maryland.

C. The transfer of a portion of a controlling interest that is exempt will be considered in determining whether there has been a transfer of controlling interest.

.08 Applicability of Other Sections.

If the transfer of a controlling interest is taxable under Tax-Property Article, §§12-117, 12-105(g), and 13-205(d), Annotated Code of Maryland, recordation and transfer taxes will be imposed based only on the latter two sections.

.09 Ending Existence.

A. If a transaction, such as a merger or consolidation, ends the existence of one or more entities, the determination of whether there has been a transfer of controlling interest of a real property entity will be based on the entity that holds the direct or beneficial interest in the real property at the beginning of the transaction.

B. If the transfer of a controlling interest of a real property entity ends the existence of that real property entity, the surviving entity or entities, regardless of whether they meet the definition of a real property entity, shall:

(1) File a report of transfer; and

(2) Pay any recordation and transfer tax due.

.10 Burden of Proof.

A real property entity has the burden of establishing to the satisfaction of the Department any information required to administer Tax-Property Article, §12-117, Annotated Code of Maryland, or this chapter.

.11 Examples.

A Delaware limited liability company (DE LLC) owns only Maryland real property with a value of \$10,000,000. A New Jersey corporation (NJ Corp) owns all of the membership interest in DE LLC, which represents 100 percent of NJ Corp's assets. A California corporation (CA Corp) owns all of the stock of NJ Corp and all of the membership interest in a Florida limited liability company (FL LLC), which represents 100 percent of CA Corp's assets. FL LLC owns only Florida real property valued at \$1,000,000. The following apply:

A. The transfer of DE LLC's membership interest is subject to recordation and transfer taxes in Maryland under Tax-Property Article, §12-117, Annotated Code of Maryland;

B. The transfer of the stock of NJ Corp is subject to recordation and transfer taxes in Maryland under Tax-Property Article, §12-117, Annotated Code of Maryland;

C. The transfer of the stock of CA Corp is subject to recordation and transfer taxes in Maryland under Tax-Property Article, §12-117, Annotated Code of Maryland, because 80 percent of its assets are still Maryland real property; and

D. In §C of this regulation, if FL LLC owns only Florida real property valued at \$5,000,000, the transfer of the stock of CA Corp is not subject to recordation and transfer taxes in Maryland under Tax-Property Article, §12-117, Annotated Code of Maryland, because CA Corp would no longer be a real property entity.

.12 Tax Avoidance.

The Department will administer Tax-Property Article, §12-117, Annotated Code of Maryland, and this chapter in the broadest legal manner to impose a tax when a transaction involving a transfer of controlling interest in a real property entity is structured to avoid the payment of the taxes.

C. JOHN SULLIVAN, JR.
Director of Assessments and Taxation