DEPARTMENT OF TAXATION
2011 Fiscal Impact Statement

1. Patron Jackson H. Miller

2. Bill Number HB 1908

House of Origin:
X **Introduced**
_____ **Substitute**
_____ **Engrossed**

Second House:
_____ **In Committee**
_____ **Substitute**
_____ **Enrolled**

3. Committee House Finance

4. Title Recordation and Grantor Taxes: Based on Consideration; Expands Refinancing Exemption; and Increases Penalty for Misrepresentation

5. Summary/Purpose:

This bill would require the recordation and grantor taxes on deeds to be based solely upon consideration, even when it is less than the actual value of the real estate conveyed by the deed. The clerk of the local court would be allowed to require documentation to verify the consideration of the deed.

This bill would expand the current recordation tax exemption for refinancing an existing debt to include refinancing with a lender different than the original lender of the debt.

Finally, this bill would increase the penalty for the fraudulent understatement of the consideration from 100 percent to 200 percent of the tax due.

The provisions requiring that recordation and grantor taxes on deeds be based upon consideration would be effective July 1, 2013. The provisions that expands the recordation tax exemption and increases the penalty for understating the consideration of the property would be effective for deeds of trust or mortgages recorded between July 1, 2011 and June 30, 2014.

6. Budget amendment necessary: No.

7. Fiscal Impact Estimates are: Preliminary. (See Line 8.)

8. Fiscal implications:

<u>Administrative Costs</u>

There would be no administrative costs to TAX to implement this bill, as the recordation tax is collected by the clerks of the local Circuit Courts. The cost for the local courts to implement this bill is unknown.

Revenue Impact

The provision of this bill that would require the recordation and grantor taxes to be based solely upon consideration would have a negative impact on General Fund revenue, Transportation Trust Fund (TTF) revenue and local recordation tax revenue. The minimum amount of revenue loss would be: (i) $5.4 million in FY 2014, $5.3 million in FY 2015 and $5 million in FY 2016 and FY 2017 in General Fund revenue; (ii) $600,000 in FY 2014 and FY 2015, $540,000 in FY 2016 and $520,000 in FY 2017 in TTF revenue; and (iii) $2.8 million in FY 2014, $2.7 million in FY 2015, $2.6 million in FY 2016 and $2.5 million in FY 2017 in local recordation tax revenue. These estimates are derived from a survey of the clerks in connection with a study of this issue in 2009.

The provision of this bill that would expand the current recordation tax exemption for refinancing an existing debt would have an unknown negative impact on General Fund revenue because expanding the current recordation tax exemption to include all refinancing would decrease the amount of recordation tax collected. Moreover, because 3 cents per $100 of value of recordation tax collected are deposited into the Transportation Trust Fund, there would be a similar reduction in TTF nongeneral fund revenue. Finally, local recordation taxes are equal to one-third of the state tax. As a result, there would be a decrease in local recordation tax revenue.

The amount of the revenue loss is unknown because the data available does not specify the amount of recordation tax that is collected on deeds of trust or mortgages, nor the portion that is due to refinancing.

9. Specific agency or political subdivisions affected:

Department of Taxation
Clerks of the Circuit Courts
All Cities and Counties

10. Technical amendment necessary: No.

11. Other comments:

Recordation and Grantor Taxes

Under current law, the Clerk of the Circuit Court will base recordation tax on the greater of the consideration or the actual value of the property conveyed by a deed. Because the deed recording system allows purchasers and lenders to identify almost everyone with an interest in real estate, Virginia and other states have historically taxed the value of the property that benefits from recordation of a deed. In most cases the consideration will be the most accurate figure for the value of property conveyed by a deed. There are several situations, however, where the consideration is less than the actual value of the property and clerks will investigate the actual value of the property conveyed. For example:

- In a forced sale, such as a foreclosure sale, the actual value of the property is rarely obtained for a number of reasons. The definition of fair market value (which is synonymous with actual value) assumes that the seller is not under any compulsion to sell.

- In a bulk sale the price may not have been negotiated for each asset and the total purchase price must be allocated among the assets. This situation occurs when the purchase price for a business must be allocated between the real estate and other assets such as inventory, machinery and good will, or when many parcels of real estate (sometimes in several jurisdictions) are purchased with a bulk discount.

- When a sales price is negotiated but the deed delivery and recordation are delayed, there may be substantial appreciation or improvements that occur between the time of sale and recordation. Subdivision developers sometimes allow builders to begin construction on a lot but delay delivering the deed for recordation until the first construction loan disbursement. See Va. Att'y Gen. Ann. Rep.: 1987-1988 at 572.

- For financing and other reasons, a purchase may be structured as a long-term lease followed by conveyance of the title for $1 or other nominal consideration. See, for example, See Va. Att'y Gen. Ann. Rep.: 1992 at 185. However, the recordation of the long-term lease would be subject to tax on the lesser of the total lease payments or the actual value of the property.

The determination of actual value is often difficult and sometimes controversial. One such example can be found in Va. Tax Public Document 91-146 (8/2/91). In that case, the clerk based the tax on the assessed value for real estate tax purposes, ignoring an appraisal that reflected a much lower value. The taxpayer protested because, among other reasons, the appraised value was being litigated. The Tax Commissioner's ruling describes several other situations in which the value assessed for real estate tax purposes may not reflect the actual value of property conveyed by a deed.

Recordation Tax Refinance Exemption

A recordation tax exemption is allowed for any deed of trust or mortgage that is refinanced with the same lender for the principal amount of the original debt.

A 1992 Virginia Attorney General opinion established that the phrase "existing debt with the same lender" means that the lender who is providing the refinancing must be the same person who owns the existing debt being refinanced. See 1992 Op. Va. Att'y Gen, at 181. The recordation tax exemption, therefore, applies when the existing debt is being refinanced by the lender who holds the debt.

Misrepresentation Penalty

In 2009, the General Assembly (2009 Acts of Assembly, Chapter 95, House Bill 2135), made it a Class 1 misdemeanor for knowingly misrepresenting the consideration for the interest in property conveyed by a deed or other instrument or any of the other information requested by the clerk of court. In addition, it established that if an understatement of the consideration is false or fraudulent with intent to evade a tax, a penalty equal to 100 percent of the tax due on the understatement would be added to the amount of the tax due, and that interest would be imposed on the tax from the time the tax was required to be filed until it was paid.

Proposal

This bill would require the recordation and grantor taxes on deeds to be based solely upon consideration, even when it is less than the actual value of the real estate conveyed by the deed. The clerk of the local court would be allowed to require documentation to verify the consideration of the deed.

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Similar Legislation

House Bill 1431 would reduce the recordation tax rate by 1.25 cents per $100 for every deed of trust or mortgage, and eliminate the reduced recordation tax based on deeds of trust or mortgages securing a refinanced mortgage with the same lender.

Senate Bill 780 would expand the current recordation tax exemption for refinancing an existing debt to include refinancing with a lender different than the original lender of the debt.

cc : Secretary of Finance

Date: 1/25/2011 TG
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