

The Recordation Tax Exemption That You Likely Never Knew Existed

Description

There is a full exemption from the Virginia grantorâ??s tax and state and local recordation taxes available on certain deeds and deeds of trust, which you have probably never heard of â?? and for good reason. You will not find the exemption anywhere in Chapter 8 of Title 58.1 of the Virginia Code; in fact, the exemption does not appear anywhere in the entire Code of Virginia. Who knew? But when the time came last fall to record a first and a second deed of trust on a large commercial property (each deed of trust securing over \$500,000,000 of principal), that largely unknown exemption saved a client a considerable sum (and probably ruined the day of a very disappointed Circuit Court Clerk). However, thereâ??s one drawback to being able to take advantage of the exemption â?? someone in the deal needs to be bankrupt!

11 U.S.C. Â§ 1146(a) (formerly Â§ 1146(c)[\[1\]](#)) is the improbable home of this hidden exemption, nestled in the United States Bankruptcy Code. It provides, with brevity, â??The issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax.â?• The phrase â??an instrument of transferâ?• is broadly construed, and thus would include a bankrupt debtorâ??s recordation of a deed of trust (transferring title to the deed of trust trustee). The reference to â??a stamp tax or similar tax,â?• of course, is similarly broadly construed to include Virginiaâ??s recordation taxes.

In a case which originated in the United States Bankruptcy Court for the Eastern District of Virginia, *NVR Homes, Inc. v. Clerks of the Circuit Court for Anne Arundel County, et al. (In re NVR, LP)*, 189 F.3d 442 (4th Cir. 1999), the Fourth Circuit Court of Appeals considered a large residential real estate developerâ??s claim against numerous Pennsylvania and Maryland local taxing authorities for the refund of transfer and recordation taxes paid on transfers the developer recorded pursuant to its reorganization plan, but which recordings occurred prior to the Bankruptcy Courtâ??s confirmation of the developerâ??s plan. While the Fourth Circuit ruled against NVR, holding that Section 1146(c) did not extend NVRâ??s exemption from â??a stamp tax or similar taxâ?• to transfers occurring outside of the plan confirmation process, the Court did confirm that Section 1146(c) of the Bankruptcy Code indeed exempted from recordation taxes transfers occurring in conjunction with the confirmation of the debtorâ??s plan.

In the financing described above, the debtorâ??s bankruptcy counsel went to great lengths to include in the Court order confirming the debtorâ??s plan language detailing the proposed bankruptcy exit financingâ??s terms and specifically invoking the Section 1146(a) exemption from recordation taxes. The front page of both Deeds of Trust bore the following â??NOTE TO CLERKâ?•:

NOTE TO CLERK: THIS DEED OF TRUST IS BEING RECORDED PURSUANT TO THE AUTHORITY AND APPROVAL OF THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF [X] BECAUSE THE GRANTOR IS ONE OF THE DEBTORS IN A CONFIRMED CHAPTER 11 CASE IN THAT BANKRUPTCY COURT, STYLED â??IN RE [X], CHAPTER 11, CASE NO. [X],â?• WHICH, INTER ALIA, AUTHORIZED AND APPROVED THE CREATION,

MODIFICATION, CONSOLIDATION, TERMINATION, REFINANCING AND/OR RECORDING OF ANY MORTGAGE, DEED OF TRUST, OR OTHER SECURITY INTEREST OR THE SECURING OF ADDITIONAL INDEBTEDNESS BY SUCH OR OTHER MEANS BY ANY DEBTOR, AND ANY SUCH ACTION (IMPLEMENTED IN THIS INSTANCE BY THIS [â?i] DEED OF TRUST) WAS SPECIFICALLY AUTHORIZED AND APPROVED IN THE CONFIRMATION ORDER OF SUCH CHAPTER 11 CASE BY THAT BANKRUPTCY COURT, DATED [X], 2020 (THE â??CONFIRMATION ORDERâ?•). FURTHER, THE CONFIRMED CHAPTER 11 PLAN AND THE CONFIRMATION ORDER SPECIFICALLY PROVIDE THAT ANY RECORDED DEED OF TRUST *SHALL NOT BE SUBJECT TO ANY DOCUMENT RECORDING TAX, STAMP TAX, CONVEYANCE FEE, INTANGIBLES OR SIMILAR TAX, MORTGAGE TAX, REAL ESTATE TRANSFER TAX, MORTGAGE RECORDING TAX, UNIFORM COMMERCIAL CODE FILING OR RECORDING FEE, REGULATORY FILING OR RECORDING FEE OR OTHER SIMILAR TAX OR GOVERNMENTAL ASSESSMENT UNDER 11 U.S.C. SECTION 1146(a)*, AND PURSUANT TO THE CONFIRMATION ORDER, THE APPROPRIATE STATE OR LOCAL GOVERNMENTAL OFFICIALS OR AGENTS SHALL FOREGO THE COLLECTION OF ANY SUCH TAX OR GOVERNMENTAL ASSESSMENT AND ACCEPT FOR FILING AND RECORDATION ANY OF THE FOREGOING INSTRUMENTS OR OTHER DOCUMENTS WITHOUT THE PAYMENT OF ANY SUCH TAX, RECORDATION FEE OR GOVERNMENTAL ASSESSMENT. ACCORDINGLY, THIS FILING IS EXEMPT FROM VIRGINIA STATE RECORDATION TAX IN VA. CODE SECTION 58.1-803 AND ANY OTHER SIMILAR VIRGINIA TAXES UNDER THAT FEDERAL LAW.

[Details marked [X] have been omitted from this article to preserve client confidentiality.]

Interestingly, the Virginia Tax Commissioner has issued two rulings further extending the reach of Bankruptcy Code Â§ 1146(a). In PD 88-271, the taxpayer requested â??a refund of state and local recordation taxes and the grantorâ??s tax paid upon recording a deed which was pursuant to a disposition order confirmed by the U. S. Bankruptcy Court.â?• The Commissioner noted that â??the deed stated that it was pursuant to a plan of reorganization which had been confirmed by the U. S. Bankruptcy Court and cited the Bankruptcy case number and other relevant information. The deed also cited the code section under which it claimed an exemption as required by Â§17-59.â?• (Va. Code Â§ 17-59 has since been recodified at Va. Code Â§ 17.1-223.) The Commissioner ruled that the Virginia grantorâ??s tax and state and local recordation taxes were sufficiently like a â??stamp taxâ?• as to be covered by Section 1146(c), and then concluded with the most interesting portion of his ruling: â??The federal exemption clearly applies to the transfer *and all documents to implement the transfer, not merely to the bankrupt party*. [Therefore,] *the deed in question may be recorded free of the state and local recordation tax as well as the state grantorâ??s tax*.â?• (emphasis added) Thus, the recordation tax exemption extended to the grantee of the deed, who was not a bankrupt debtor.

Emboldened by the Commissionerâ??s generous interpretation in PD 88-271, the following year another creative taxpayer succeeded in pushing the envelope even further. In PD 89-352, the Virginia Tax Commissioner considered a taxpayerâ??s request for â??a refund of state and local recordation taxes paid upon recording a deed of trust. The Taxpayer purchased property from the debtor pursuant to a sale confirmed by the U. S. Bankruptcy Court. To obtain financing for the purchase, the Taxpayer executed a deed of trust with a financial institution, secured by the property purchased from the debtor.â?• To the Commissionerâ??s credit, he did not shy away from the implications of his ruling in PD 88-271 that â??the federal exemption under 11 U.S.C.A. Â§1146(c) â??applies to the transfer *and all documents to implement the transfer, not merely to the bankrupt partyâ??* [Emphasis added].â?• Rather, the Commissioner held steadfast to his prior ruling, stating:

The order of the bankruptcy court confirming the sale stated that the sale of the debtorâ??s real property â??is hereby ratified, confirmed and approved as per the terms of the said settlement sheet.â?•

- The settlement sheet listed under Summary of Borrowerâ??s Transaction, line 202. â??Principal amount of new loan(s)***** (the amount of the deed of trust). By confirming the sale as per the terms of the settlement sheet, the court implicitly confirmed this item, which represents the financing of the sale. The financing, obtained in this case through a deed of trust, was confirmed as part of the sale. Consequently, the deed of trust was entitled to an exemption from the recordation tax under 1146(c) as a document to implement the transfer.

So, somewhat amazingly, PD 89-352 extended the reach of 11 U.S.C. 1146(c) to allow a purchaser of property from a bankrupt debtor, in a transaction where the parties took care to ensure the order confirming the debtorâ??s plan included details of the purchaserâ??s financing, to claim the tax exemption for the purchaserâ??s deed of trust.

To recap, the keys to claiming this arcane tax exemption are: (1) the transfer must occur after the debtorâ??s plan has been confirmed by the Bankruptcy Court, and the transfer must follow the requirements set forth in the plan confirmation order; (2) the plan confirmation order must specifically invoke the Â§ 1146(a) tax exemption; (3) if the Â§ 1146(a) tax exemption is going to be claimed by any party other than the debtor, the extended details of the other partyâ??s transaction also need to be recited with specificity in the Bankruptcy Courtâ??s plan confirmation order; (4) the first page of the instrument being recorded must include a reference to 11 U.S.C. Â§ 1146(a) to satisfy the requirement of Va. Code Â§ 17.1-223.A.(iv) that (unless thereâ??s a cover sheet), â??the laws of the United States or the Commonwealth under which any exemption from recordation taxes is claimed is clearly stated on the face of the writingâ?•; and (5) although not statutorily mandated, including on the front page of the instrument to be recorded a detailed â??Note to Clerk,â?• specifying the foregoing compliance with all the bankruptcy requirements is highly recommended.

[1] References herein to (a) or (c) depend on whether it arose before or after its recodification



William L. Nusbaum

William L. Nusbaum is a shareholder at Williams Mullen, practicing in its Norfolk office. His practice focuses on commercial real estate, municipal bonds, economic development incentives, Commercial Property Assessed Clean Energy (â??C-PACEâ?) financing, and alcoholic beverage licensing. He graduated with an A.B. from Harvard College in 1977 and received his J.D. from the University of Virginia School of Law in 1980. A past Chair of both the Board of Governors of the Real Property Section of the Virginia State Bar and its Commercial Real Estate Committee, he now serves on the Boards of Directors of the Virginia Association for Commercial Real Estate (â??VACREâ?) and the Hampton Roads Association for Commercial Real Estate (â??HRACREâ?), and as Secretary of HRACRE. The author expresses his profound gratitude to his Williams Mullen bankruptcy partner, Jennifer McLain McLemore, for her assistance with the bankruptcy law aspects of this article.

Category

1. Settlements
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Author

vltaexaminer

VLTA Examiner