

## Real Estate Transfer Taxes: Widely Used, Little Conformity

by Patricia Atkins, Catherine Collins, and Lisa Lowry

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In this article, the authors discuss the importance of transfer and mortgage taxes to state and local governments. They note not only the disparate methods and rates of the taxes' imposition among those jurisdictions but also the varied uses for the resulting revenue.

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In 2014 nearly 5.4 million residential properties were sold in the United States, as were 123,000 commercial properties within the major U.S. markets.<sup>1</sup> Sales transactions for those and other real estate properties are subject to real estate transfer or mortgage recording taxes — or both — in 75 percent of the states, raising \$6.8 billion<sup>2</sup> in 2014 for states and billions more at the local level.

The basic concept of the real estate transfer tax or mortgage recording tax is straightforward. At the time of sale or transfer, real property is registered or a mortgage is recorded and the tax is levied. The taxes are levied on property transactions as a percentage of the value of property (a real estate transfer tax) or as a percentage of the long-term debt (a mortgage recording tax).<sup>3</sup> This article refers to the two taxes as transfer tax and mortgage tax, respectively.

Transfer and mortgage tax antecedents date back to taxes on legal instruments or writings first imposed in the United States in 1797. The federal government has had a pattern of adopting the taxes when revenue was needed, especially to support military actions, and then repealing them when the wars were over.<sup>4</sup>

Modeled after English law precursors that were imposed on legal instruments, bonds, deeds, and debt instruments, the federal tax was generally levied on two broad types of transactions: the transfer of real property and the issuance and transfer of capital stocks and corporate bonds. This article focuses on the first group — transfers of real property.

Regarding the second group, the tax on stock transfers has been all but eliminated by the states; only New York's stock transfer tax remains, though effectively repealed because the broker receives a full tax rebate from the state on submission of a claim.<sup>5</sup> This article focuses only on taxation as part of a property transaction. The federal government, having shed the mortgage tax in 1914, repealed the federal transfer tax for the last time in 1965, but it pushed the effective date to January 1, 1968, so that states might enact their own versions of the tax.

### Imposing Transfer and Mortgage Taxes

A central concept of taxation is transparency. When a tax is imposed, the taxpayer should know which government authorizes the tax, which one levies the tax, who sets the rates, how the tax is calculated, which government collects the revenue, and which government lays claim to the revenue. The transfer tax lacks transparency, partly because of the subtle differences in the tax given each state's historical,

<sup>1</sup>National Association of Realtors, "Field Guide to Quick Real Estate Statistics" (July 2015); and Anthony J. Buonicore, "Market Intelligence Report: First Quarter 2015," Environmental Data Resources (2015).

<sup>2</sup>U.S. Census Bureau, Annual Survey of State Government Tax Collections, Documentary and Stock Transfer Taxes, through April 16, 2015, revisions with 2014 data from detailed tables, available at <http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk>.

<sup>3</sup>Arizona and New Orleans — sometimes included in accounts of transfer taxes — are excluded here because theirs are flat fees, and this article defines transfer and mortgage taxes as ones that are calculated on the value of the property or debt.

<sup>4</sup>Advisory Commission on Intergovernmental Relations, "The Intergovernmental Aspects of Documentary Taxes: A Commission Report," A-23 (Sept. 1964), footnote at 4.

<sup>5</sup>Most states have repealed the transfer tax on stocks, the most recent being: Massachusetts with Mass. Gen. Laws, Ch. 64, section 1 in 1954 (Ch. 353); Pennsylvania with 72 P.S. sections 2041, 2042 in 1957 (P.L. 671, section 1); Texas with art. 16.01 in 1981 (Ch. 389); Florida with Fla. Stat. section 201.04 in 1987 (Ch. 102); and South Carolina with section 12-21-340 in 1996 (Act 458, Part II, section 57). In some states, the transfer tax is imposed on other realty, including transfers of mineral leaseholds, transfers of mineral interests, and transfers of long-term leases. Those various other types of transactions, while taxable, are not part of this review.

Transfer and Mortgage Tax Authorizations, 2014					
State Transfer Tax	State Transfer Tax And Mandated Local Transfer Tax With Local Rate Option	State Transfer Tax With Local Rate Option	Mandated Local Transfer Tax With Local Rate Option	Local Rate Option	No State or Local Transfer Tax
Alabama Arkansas Florida <sup>a</sup> Georgia Hawaii Iowa Maine Massachusetts <sup>b</sup> Minnesota <sup>b,c</sup> Nebraska New Hampshire North Carolina <sup>b</sup> Oklahoma Rhode Island <sup>b</sup> Tennessee <sup>d</sup> Vermont Wisconsin	Connecticut <sup>a</sup> Michigan <sup>a</sup> Nevada <sup>a,b</sup> New Jersey <sup>a</sup> South Carolina <sup>d,f</sup> West Virginia	Delaware Illinois <sup>a</sup> Maryland <sup>b,a</sup> New York <sup>b,a</sup> Pennsylvania Virginia <sup>a</sup> Washington	Colorado <sup>e,g</sup> Kentucky <sup>a</sup> Ohio South Dakota <sup>a</sup>	California	Alaska Arizona <sup>h</sup> Idaho Indiana Kansas Louisiana <sup>h</sup> Mississippi Missouri <sup>h</sup> Montana <sup>h</sup> New Mexico North Dakota <sup>h</sup> Oregon <sup>e,h</sup> Texas Utah Wyoming
<i>Note:</i> The District of Columbia imposes a deed transfer tax and a deed recordation tax.					
<sup>a</sup> A specific state statute or act is used to grant localities identified by certain characteristics the option to impose a local transfer tax. <sup>b</sup> A specific state statute or act is used to grant named locality the option to impose a local transfer tax. <sup>c</sup> There are local mortgage taxes. <sup>d</sup> State statutes prohibit imposition of a local transfer tax. <sup>e</sup> There is no local option available for counties to increase the local rate. <sup>f</sup> Optional local transfer tax predates ban and remains in effect. <sup>g</sup> State constitution prohibits imposition of transfer or mortgage taxes. <b>Bold:</b> State imposes a state mortgage tax. <i>Italics:</i> A five-year phaseout of the state mortgage tax begins in 2015.					
<i>Source:</i> Compiled by authors from the website Significant Features of the Property Tax, a joint venture between Lincoln Institute of Land Policy and George Washington Institute of Public Policy, available at <a href="https://www.lincolninstitute.org/subcenters/significant-features-property-tax/">https://www.lincolninstitute.org/subcenters/significant-features-property-tax/</a> .					

political, and geographic situation. Those differences also make it difficult to develop distinct and exclusive categories.<sup>6</sup>

The table above categorizes transfer and mortgage tax approaches across the 50 states and the District of Columbia based on data drawn primarily from the Significant Features of the Property Tax website.<sup>7</sup> According to the table:

- 12 states have only a state transfer tax;
- five states with a state transfer tax have local transfer taxes in isolated instances;
- 13 states with a state transfer tax have widespread use of local transfer taxes;
- four states with a state transfer tax direct all state transfer tax proceeds to be retained by the county and as such are treated here as local transfer taxes;
- one state has only widespread local transfer taxes;

- one state has only a preexisting single local transfer tax with others now prohibited;
- one state has only a state mortgage tax;
- 13 states have no state transfer or mortgage taxes and no local transfer or mortgage taxes; and
- the District has transfer taxes.

For the five states with the scattering of local transfer taxes, most were adopted in the late 1980s and one state in the late 1990s.<sup>8</sup> Given the lack of appetite for those taxes, it is unlikely that the states will grant authority for additional local taxes any time soon. For those reasons, this article groups them with states having solely state transfer taxes. Another distinct grouping in this article is treatment of the levy of a mandated statewide transfer tax whose proceeds are retained entirely at the county level as a mandated local transfer tax, the circumstance for four states.<sup>9</sup> Given that assumption, 24 states have at least one locality with a local transfer tax.

<sup>6</sup>Efforts by other organizations to group these taxes have produced other arrangements. Table 1 reflects decisions made by the authors for this overview and differs from those other compilations.

<sup>7</sup>"Significant Features of the Property Tax" is a joint venture between Lincoln Institute of Land Policy and George Washington Institute of Public Policy.

<sup>8</sup>In the 1980s: Florida, Massachusetts, North Carolina, and Rhode Island. In the 1990s: Minnesota.

<sup>9</sup>Colorado, Kentucky, Ohio, and South Dakota. Also, Colorado and Ohio have municipalities and counties, respectively, that optionally impose local transfer taxes.

Authority for local transfer taxes ranges from a single county's tax in Oregon,<sup>10</sup> which was imposed before the statewide ban, to hundreds of counties and cities in California. Local governments in Colorado, Oregon, and South Carolina, in the absence of explicit state statutory authorization over the years, have levied local transfer taxes via local ordinances, and the numbers have fluctuated as localities variously adopt and repeal the tax until the states prohibit any new local authorizations.

Hawaii, California, and Kentucky illustrate the policy variety across the states and localities. Hawaii is state-centric, the tax being imposed by and collected by the state with all revenue going to three statutorily dedicated state funds. Conversely, California is local-centric, having no state tax and permitting counties and cities the option to impose a local tax on adoption of an ordinance. For counties and general-law (non-charter) cities, the state has set a standard rate for local adoption, with the city tax, if adopted, as a credit against the county tax. Charter cities are not restricted to the rate established by the state and can impose higher rates, but that higher rate cannot be applied as a credit against the county tax. Kentucky statutes set a uniform statewide rate, but then mandate that the counties impose, collect, and retain the revenue for the county's general fund.

New Jersey highlights the difficulty in labeling a tax as a state or local tax. The transfer tax has five different elements. The basic fee has a state and a county component with the rates set and mandated by the state. An additional state fee is imposed on properties in excess of \$150,000. Also, there is a general purpose graduated fee for properties in excess of \$350,000. The fourth fee is a supplemental fee imposed at a graduated state-mandated rate with a set rate retained partly by the counties to replace previous state funding for county priority health services. Revenue in excess of the previous state funding level is available to the county for general county purposes. The state portion of the supplemental fee is deposited to the Extraordinary Aid program account for the purposes of providing special education aid and municipal property tax relief aid. The fifth and final component is for properties in excess of \$1 million, which is solely a state tax.

Nine states have both transfer and mortgage taxes, and one state, Kansas, has only a mortgage tax. Kansas enacted legislation in 2014 to phase out its mortgage tax over five years, beginning in 2015. Only four states allow local mortgage taxes. As with local transfer taxes, local mortgage taxes must be authorized by the state.

The nine states with both taxes differ in how the two taxes are interrelated. In five states that have both taxes, the transfer tax is applied to the full sale price of the property,

including the amount of any mortgage, and in three it is applied only to the value exclusive of any lien or mortgage that the buyer assumes from the seller. Only Alabama nets the value of the buyer's mortgage from the sales price. Another variation among states is whether a refinancing of a mortgage is taxable like an initial mortgage.

The interplay of the mortgage and transfer taxes at both the state and local levels can be perplexing. Maryland exemplifies the overlap of both the transfer and mortgage taxes imposed by state and local governments. The transfer of property in Maryland requires payment of a state transfer tax and an optional local transfer tax when the transaction occurs in a county that has adopted a local tax. The city of Baltimore and 16 of 23 counties impose the local component.<sup>11</sup> On the transfer of property with a mortgage or deed of trust, a recordation tax is due. The recordation tax is mandated statewide by the state, but the rates are set and imposed locally by the counties and Baltimore.

### Setting the Rates

In addition to authorizing local governments to impose transaction taxes, states have set the guidelines for the local rates. There is a broad range among states in their grant of local rate setting autonomy. States such as New Jersey and South Carolina mandate the local rate for transfer taxes. Ohio, however, mandates a statewide rate to be applied in all counties, but the state also allows counties to impose an additional local tax at their own option, up to three times the statewide rate.<sup>12</sup>

Some counties in Nevada have a possibility of three local rates: a statewide-mandated local rate at 65 cents per \$500 for counties with fewer than 700,000 residents, and \$1.25 per \$500 for Clark County; the optional Local Government Tax Act (LGTA), at up to 10 cents per \$500; or, for counties with fewer than 700,000 residents, an additional 5 cents per \$500 for the state's optional Plant Industry Program. While only Churchill and Washoe counties have adopted the LGTA tax, no counties have adopted the Plant Industry Program tax.<sup>13</sup>

Some states and jurisdictions have a tiered or graduated rate structure, usually based on the value of either consideration paid for the property or the mortgage secured by the property. Most, however, apply a single rate to all transactions. Oklahoma has an unusual approach: The rate for the mortgage tax is based on the term of the loan with higher

<sup>11</sup>Department of Legislative Services, State of Maryland, *Legislative Handbook Series*, vol. 6 at 145 (2014).

<sup>12</sup>Ohio's statewide mandatory tax rate is \$1 per \$1,000, with the permissive rate of up to \$3 per \$1,000.

<sup>13</sup>Nevada Department of Taxation, Division of Local Government Services, "Real Property Transfer Tax Reporting Guide," at 4 (revised Apr. 2014).

<sup>10</sup>Oregon, with only a transfer tax in Washington County, is grouped with states that have no transfer taxes.

rates for longer terms — 0.02 percent for a mortgage less than two years up to 0.1 percent for a term of five years or more.

In imposing the taxes, for policy purposes, states make adjustments to the value of the transfer that is subject to tax or the rates. Many states set a minimum property value before the tax kicks in or they allow local jurisdictions to determine their own exemption level. Maryland counties are permitted to determine the exemption level, which ranges statewide from \$22,000 to \$50,000. Clearly, the upper level reflects an effort to get more lower-priced properties into the tax exemption category.

Consideration is also given when principal residences are transferred. Vermont applies a lower rate to the first \$100,000 of value of the owner's principal residence. Similarly, Hawaii imposes the transfer tax at a higher rate when the residence will not be the owner's principal residence. In Maryland the state transfer tax rate is cut in half for first-time Maryland home buyers and is payable entirely by the seller.

In New York City the transfer tax rate on residential property is lower than for other types of property. The rate is 1 percent when the consideration is \$500,000 or less and 1.425 percent for property above that value. For nonresidential property valued at \$500,000 or less, the rate is 1.425 percent, and the rate is 2.625 percent for those valued at more than \$500,000. In addition to the city tax, the state imposes the transfer tax at a single rate of 0.4 percent. However, for residential property of \$1 million or more, an additional 1 percent state tax, dubbed the mansion tax, is imposed. The transfer of a pricey residence in New York City faces a total state and local rate of 2.825 percent.

Higher rates on expensive properties are imposed in other states. Connecticut levies a higher rate on more expensive homes, specifically, those above \$800,000, as well as on nonresidential properties.<sup>14</sup> New Jersey initially enacted a mansion tax but a year later extended the higher rate to commercial properties as well.<sup>15</sup> Hawaii in 2005 introduced graduated rates, with the highest 2005 rate imposed on properties valued at more than \$1 million.<sup>16</sup> The state expanded the rates in 2009, with the top rate now for properties valued at over \$10 million.<sup>17</sup>

Other states make distinctions in rates based on the population of the taxing jurisdictions. As discussed above, Nevada has a uniform rate of \$1.30 per \$500, but state-mandated local rates differ — \$1.25 per \$500 in counties with populations above 700,000 (Clark County) and 65 cents in all other counties. Michigan gives counties with

populations of more than 2 million<sup>18</sup> the option to increase the local rate. Washington permits counties and cities of 5,000 or more with a growth management plan to levy an optional local rate not exceeding 0.25 percent.

### Range of Rates

State transfer tax rates range from a nominal 0.1 percent in several states to 2.21 percent in New Jersey on any property selling for more than \$1 million. In Colorado, local transfer tax rates mandated by the state are a low of 0.01 percent for all counties; that rate is considered a local rate in this article since the counties retain all of the state tax revenue as noted earlier. Connecticut and Clark County in Nevada have a high of 0.25 percent.

Optional local transfer taxes range from 0.01 percent in Minnesota to 2.625 percent in New York City for nonresidential properties valued at more than \$500,000, to 3.5 percent in Reading, Pennsylvania, and to 4 percent in Ophir, Colorado. Rhode Island's top marginal rate of 4 percent for Little Compton is comparatively high, and at a glance it looks to tie Ophir. However, because of the tax's multitiered structure, the effective local tax rate on a \$1 million home is only 3.25 percent.

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Charter cities in California and home rule governments in Pennsylvania have no rate limits. California charter cities, however, as a result of legal interpretations, do have a statutory restriction that was enacted to comply with Proposition 62. Charter cities are not permitted to dedicate that revenue to a specific program or service.

Given that Pennsylvania's home rule provides unfettered local transfer tax rate-setting and its state rate is in the top third among states, it is no surprise that the state has the highest combined state/local rate. The 5 percent combined rate in Reading includes the city's 3.5 percent rate, the school district's 0.5 percent rate, and the state's 1 percent rate.<sup>19</sup>

There are other rates that approach Reading, Pennsylvania's combined rate. The combined effective rate for Little Compton, Colorado, is 3.71 percent. Ophir, Colorado's top

<sup>18</sup>Wayne County does not levy the optional rate; further, its population has fallen below 2 million, making the county unqualified for that optional rate. It had been the sole eligible county.

<sup>19</sup>Pennsylvania Economy League, Central Pennsylvania Division, "Structuring Healthy Communities: Municipal Case Studies," at 3-5 (Mar. 31, 2009); and Home Rule Charter and Optional Plans Laws, Act 62 of 1972.

<sup>14</sup>2011 Conn. Laws Act 6 section 102.

<sup>15</sup>2006 N.J. Laws Act 33 section 1.

<sup>16</sup>2005 Hawaii Laws Act 156.

<sup>17</sup>2009 Hawaii Laws Act 59 section 3.

local rate of 4 percent is tempered by the nominal 0.01 percent rate mandated by the state that is collected and retained by counties for a combined rate of 4.01 percent. The combined New York State and city rate for properties valued at more than \$1 million is 4.025 percent. Appendix A sets out the state rates and the mandated and optional local transfer tax rates.

Nine states append a charge to their state transfer or mortgage tax rates, usually to fund a particular state or local program. Eight have a fixed flat fee and one adds a surtax.<sup>20</sup> For example, West Virginia adds \$20 to its state transfer tax, with the funds dedicated to the Affordable Housing Trust Fund. In Minnesota, the three counties that participate in the state's Agricultural Land Preservation Program and all seven eligible counties that participate in the state's Metropolitan Agricultural Preserves Program impose a \$5 agricultural conservation fee on any deed transferred or mortgage registered that is subject to transfer or mortgage taxes. The money is used to reimburse taxing jurisdictions for tax losses from property tax credits granted to agricultural property.<sup>21</sup>

### Limitations on Imposing the Transfer and Mortgage Taxes

The passage of the Colorado Taxpayer Bill of Rights in 1992 imposed tax limitations even on home rule jurisdictions. Constitutional language under TABOR explicitly prohibits "new or increased transfer tax rates on real property." While no Colorado municipality can impose a new transfer tax, the mandated statewide tax collected and retained by counties and the 12 municipal taxes adopted before TABOR remain in effect.<sup>22</sup>

Washington County, Oregon, has a similar, albeit somewhat rockier, story. Based on the county's interpretation of home rule authority, the County Board of Commissioners adopted the tax in 1972, only to see it almost immediately repealed by voters. But then in 1977 the tax was reenacted.<sup>23</sup> The state later imposed a moratorium on local authority to impose the tax, and in 1999 it statutorily banned such taxes. The constitutional ban came in 2012 when voters approved a statewide ballot measure to prohibit new state or local government transfer taxes but left the tax in place in the one county.<sup>24</sup>

In addition to Colorado and Oregon, five other states — Arizona, Louisiana, Missouri, Montana, and North Dakota — impose a constitutional ban to prohibit future use of the tax, with voters having overwhelming approved the bans in

most instances.<sup>25</sup> Other states prohibit it only at the local level, using various approaches.

Examples include states that have statutorily banned local transfer tax adoption (Tennessee<sup>26</sup>), repealed authority once provided to counties through general statutes although still permitting local transfer tax adoption through state specific acts enacted at the request of local delegations (North Carolina<sup>27</sup>), or statutorily banned local transfer taxes unless specifically authorized by the legislature (South Carolina<sup>28</sup>). States that have not banned the taxes may impose restrictions, including specifying the duration of the taxes or dedicating the revenue for some funds or uses.

Eight states — Florida, Maryland, Massachusetts, Minnesota, Nevada, New York, North Carolina, and Rhode Island — use specific acts to authorize local governments to adopt a transfer or mortgage tax. The acts specify a single or a few jurisdictions by name, or they define the narrow characteristics that provide eligibility to jurisdictions. Five of the eight states do not codify those specific acts into the general laws of the state, making it more difficult to retrieve legislative history and to create a complete inventory of laws regarding local transfer taxes.<sup>29</sup>

North Carolina has tried both approaches: a general law and specific acts, settling on the latter. The state enacted specific acts during the 1980s to authorize transfer taxes for each of seven named counties, and six later adopted them. In 2007 the General Assembly, through general legislation, authorized an optional local transfer tax to any county. While many counties proposed local adoption, none were successful. In 2011 the legislature repealed the general authorization. The six counties were not affected by the repeal,

<sup>25</sup>Voter support for a state constitutional ban: Arizona, 2008 Proposition 100 (77 percent); Colorado, 1992 Initiative 1 (54 percent); Louisiana, 2011 Amendment 1 (81 percent); Missouri, 2010 Amendment 3 (84 percent); Montana, 2010 Constitutional Initiative 105 (73 percent); North Dakota, 2014 Measure 2, (75 percent); and Oregon, 2012 Measure 79 (59 percent).

<sup>26</sup>Tennessee Code Annotated section 67-4-401.

<sup>27</sup>N.C. Gen. Stat. section 105-600 through -604, repealed.

<sup>28</sup>S.C. Code Ann. section 6-1-70(A); S.C. Code Ann. section 6-1-310.

<sup>29</sup>New York and Minnesota codify the specific acts regarding local transfer and mortgage taxes, Nevada codifies most local transfer tax legislation except for two specific acts, and the remaining five states do not codify those specific acts into the state statutes. Maryland, one of the five, has not published those specific acts, which the state calls public local laws, as part of its general statutes since 1930, as noted in "Maryland Local Law Statutory Sources," Thurgood Marshall Law Library, accessed Sept. 8, 2015, available at <http://law.umaryland.libguides.com/content.php?pid=467491&sid=3827396>. Tennessee had been a member of that group through enactment in 1969 of specific private acts for two counties with both counties adopting. However, one county transfer tax was declared unconstitutional by the county chancery court, and a second was later repealed by the local jurisdiction. Tennessee later statutorily prohibited counties from enacting the tax in 2006 with Act 953 creating section 67-4-2901 through -2913.

<sup>20</sup>The eight states with an appended flat fee are Minnesota, New Hampshire, Ohio, Oklahoma, Tennessee, Virginia, Washington, and West Virginia. Massachusetts adds a surtax to its state transfer tax rate.

<sup>21</sup>Hennepin County and Ramsey County also have local transfer and mortgage taxes in addition to the fee.

<sup>22</sup>A 13th municipality repealed its tax after TABOR.

<sup>23</sup>Dana Tims, "Real Estate Transfer Tax Soon Could Be Washington County's Alone," *The Oregonian/OregonLive*, July 12, 2012.

<sup>24</sup>Or. Rev. Stat. section 306.815, Ore. Const. Art. IX, section 15.

and their transfer taxes remain in effect; the seventh continues to retain the option to impose the tax with voter approval. Counties remain able to use specific acts if sponsored and then passed by the state legislature.

South Carolina's path to statutory prohibition is complicated. Relying on home rule power, the town of Hilton Head Island enacted a local transfer tax in 1990.<sup>30</sup> Following the town's example, other local jurisdictions enacted the tax.<sup>31</sup> In 1993 the state supreme court upheld the Hilton Head authority to impose the tax.<sup>32</sup> In 1994 the Legislature nullified the effect of the court decision upholding the tax by requiring that the collected local revenue be remitted back to the state or be offset by a reduction in aid, except in localities levying before August 1993.<sup>33</sup>

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The impact of the 1994 legislation would have been to require Charleston — the only other community besides Hilton Head Island to collect revenue from that tax — to return the revenue and remit any future revenue to the state. Hilton Head was unaffected, having instituted its tax before August 1993, a grandfathering the state allowed because the town's tax revenue was already financially committed.<sup>34</sup> In a compromise with the state, Charleston officials agreed to forgo the city's future use of the tax in exchange for keeping all prior collected revenue.<sup>35</sup>

The other localities in South Carolina had yet to collect any transfer tax revenue. The Legislature's next response was to amend the statutes regarding the transfer tax to include a mandated county tax, effective June 19, 1996.<sup>36</sup> Groups challenged the 1994 state law requiring returns and remittances that had forced Charleston officials' hands but failed at the effort in early 1997.<sup>37</sup> Later that year, the Legislature prohibited the imposition of new taxes after December 1996 by any localities not having the tax before January

1991 unless the Legislature expressly authorized it, effective July 1, 1997.<sup>38</sup> That allowed Hilton Head to keep its tax, until December 31, 2024, as set out in the town's municipal code.<sup>39</sup> Both the state and mandatory county transfer taxes remain in place, while Hilton Head Island is the only South Carolina town that has the optional local transfer tax.

### Transactions Subject to Tax

A major consideration in imposing the taxes is defining a taxable event. There are common exemptions: transfers between family members, transfers between governmental bodies, transfers when there is no consideration, and transfers of property below a nominal value.

Increasingly problematic are transactions that occur when property changes hands by an owner transferring economic interests in an entity that owns the property rather than by transferring the property outright. A Florida Supreme Court decision in 2005 identified such transactions as outside the reach of the state's documentary transfer tax.<sup>40</sup> As a result of that decision, a 2008 Florida Senate report predicted that "erosion of the tax base will continue and will accelerate for properties with a just value exceeding \$500,000."<sup>41</sup> To mitigate the impact of the decision, the Florida Legislature expanded the tax in 2009 to include as taxable the transfer of such interests, at least partially closing the loophole.<sup>42</sup>

Florida was not alone in having to deal with property changing hands via the transfer of controlling interests. The recent trend has been for more states to impose a transfer tax on the transfer of economic or controlling interests, and, as of mid-2013, those stood at 14 states.<sup>43</sup> Given the intricate legal issues raised by those types of transactions, the treatment of controlling interest is beyond this review, and a fuller discussion can be found in an earlier *State Tax Notes*.<sup>44</sup>

### Use of Funds

While the transfer and mortgage taxes are not substantial revenue sources in most cases, they are important for the maintenance of accurate property tax records. By having all sales reported to the county, the county assessor can determine market prices, an essential component of the property tax, as well as note the owner.

<sup>30</sup>Town of Hilton Head Island, South Carolina, Code of Ord., 1990, No. 26.

<sup>31</sup>Jon Segal, "Officials Push for Reinstatement of Real Estate Fee," *The Island Packet*, Nov. 7, 2000.

<sup>32</sup>*Williams v. The Town of Hilton Head Island*, 429 S.E.2d 802 (1993).

<sup>33</sup>1994 S.C. Laws Act 497.

<sup>34</sup>Ginny Skalski, "Herbkersman to File Bill to Allow Real-Estate Fee," *The Island Packet*, Mar. 16, 2006.

<sup>35</sup>Robert Behre, "July 1 Marks End to Real Estate Fee," *The Post and Courier*, June 19, 1997, at 6-B.

<sup>36</sup>1996 S.C. Laws Act 458.

<sup>37</sup>*The Town of Hilton Head Island v. Morris* (484 S.E. 2d 104 1997).

<sup>38</sup>1997 S.C. Laws Act 155.

<sup>39</sup>Municipal Code of the Town of Hilton Head Island, section 4-5-20 — Real estate transfer fee.

<sup>40</sup>*Crescent Miami Center LLC v. Florida Dep't of Revenue*, 903 So.2d 913 (2005).

<sup>41</sup>Committee on Finance and Tax, The Florida Senate, Interim Report 2009-113, "Documentary State Tax on Real Property Transfers After *Crescent Miami*," at 1 (Oct. 2008).

<sup>42</sup>2009 Fla. Laws Act 131 sections 1, 2, 4, 7, and 8.

<sup>43</sup>Robert Mouton and Matt Hart, "The Controlling Interest Transfer Tax," 29 *The Practical Real Estate Lawyer* 34 (July 2013).

<sup>44</sup>Maria P. Eberle and Hayes R. Holderness, "The Transfer Tax Trap — It's Real," *State Tax Notes*, Sept. 2, 2013, p. 605.

The Colorado General Assembly made the connection of using the transfer tax for those purposes, as well as to determine whether the revenue was to go to the county. Using the lesser-used term “documentary fees” for “transfer taxes,” legislative staffers wrote that “documentary fees are currently used to defray the costs incurred by county administrators for filing, recording, and releasing title or lien on real property. The purpose of imposing a documentary fee on the conveyance of real property is to develop a continuing county-by-county record to compare properties for assessment purposes.”<sup>45</sup>

As those remarks noted, the information also provides states with critical information to be used to confirm the accuracy of the tax rolls. Because county officials are generally the collection agents, 15 states allow the counties to retain a portion of collections as an agent fee.

States have other, greater purposes for the tax revenue, as well. For example, three long-standing policies supported by transfer and mortgage tax revenue are conservation or open space protection, housing, and public infrastructure in fast-growing metropolitan areas.

**Three long-standing policies supported by transfer and mortgage tax revenue are conservation or open space protection, housing, and public infrastructure in fast-growing metropolitan areas.**

Many states support permitting localities to impose a transfer tax, linking it to preserving open space or slowing down speculation, especially in booming real estate markets. When Crested Butte, Colorado, a mountain ski resort town, adopted a deed transfer tax in 1979, the tax rate was based on the length of time the property was owned. The highest rate was 5 percent for property owned for less than one year and was reduced to 0.5 percent when the property had been owned for five to 10 years. No tax was due if the property had been owned for 10 or more years.<sup>46</sup> That has since been changed, and the rate is now 3 percent on all properties.

Two counties in Massachusetts — Dukes County, which includes Martha’s Vineyard, and Nantucket County — each impose a local transfer tax with revenue used to purchase beach property along with other recreational land to protect sensitive lands from development. And two towns in Rhode Island impose a similar tax in which revenue goes to the purchase of open, agricultural, or coastal lands.<sup>47</sup> As

discussed earlier, North Carolina authorized a transfer tax for some coastal counties to be used solely for capital expenditures or debt service, insulating general expenditures from the volatility of transfer taxes. In Florida the documentary stamp tax revenue is largely dedicated to conservation and open space. Revenue supports bond programs designed to acquire conservation and recreational land and restore the Everglades.

Maryland recognized the relationship between open space and real estate activity at the state level. When the transfer tax was enacted, the General Assembly created the state’s Program Open Space, stating that the purchase of land for private purposes puts pressure on existing public land. “The premise of the program was that one acre developed equated to one acre preserved,” it said.<sup>48</sup> Also, the link between real estate transfer taxes and open space should adjust to market pressures. A robust real estate market generates strong tax revenue when pressure on conservation and open space would be greater.

An alternative to preserving vulnerable property is to exempt some types of property from the tax at the time of transfer. Delaware entirely exempts the transfer of agricultural property from the state tax. If within three years of the transfer the property is no longer used for agriculture, the tax is due. Connecticut, on the other hand, taxes such a transfer; however, if the transferred property is used for purposes other than agriculture within 10 years, a significant penalty is imposed.<sup>49</sup>

A second policy area supported by real estate transfer taxes is housing. Many states dedicate at least a portion of that revenue to housing programs. Florida allows some home rule counties the option to impose a local tax on nonresidential properties with revenue dedicated specifically to low-income housing assistance programs.

Miami-Dade County, Florida, adopted that optional local tax, and when Florida raised the state rate from 60 cents to 70 cents per \$100 in 1992, the county rate remained at the 60-cent rate.<sup>50</sup> Miami-Dade has used its local revenue from the optional local tax for a wide variety of housing programs assisting low- and moderate-income households. And the District of Columbia sets aside 15 percent of both the recordation and transfer taxes for the Housing Production Trust Fund to provide loans and grants for the development of affordable housing.

<sup>45</sup>Colorado Legislative Council Staff Fiscal Note, “Final Fiscal Note, HB08-1340,” at 2 (May 28, 2008).

<sup>46</sup>John L. Crompton and Susan R. Orton, “The Real Estate Transfer Tax: An Alternative Source of Park Acquisition and Development Funds,” 5 *J. of Park and Recreation Admin.* 23 (1987).

<sup>47</sup>Nantucket County (Nantucket Islands Land Bank), 1983 Mass. Laws Act 669; Duke County (Martha’s Vineyard Land Bank), 1985

(Footnote continued in next column.)

Mass. Laws Act 736; Little Compton (Little Compton Agricultural Conservancy Trust), 1985 R.I. Laws Act 16; and New Shoreham (Block Island Land Trust), 1986 R.I. Laws Act 268.

<sup>48</sup>Crompton et al. *op. cit.*

<sup>49</sup>Conn. Gen. Stat. section 12-504c.

<sup>50</sup>Florida Legislature, “1992 Summary of General Legislation,” at 136 (Sept. 1992).

A third policy area regarding transfer and mortgage taxes is the enactment of taxes to provide additional public services in fast-growing metropolitan areas for capital improvement projects in cities and counties. More recently, states have directed that policy toward regions that need to relieve metropolitan traffic congestion and to shore up the financial position of area public transit.

Washington has been at the forefront of using transfer taxes to support capital projects. In 1982 it gave counties and cities the option to levy a local transfer tax to fund local capital improvement projects.<sup>51</sup> Permitted projects include, among many, bridges, sidewalks, parks, libraries, and waterway flood control projects.

The Illinois General Assembly in 2008 enacted legislation permitting Chicago to increase the rate of its existing transfer tax specifically to provide assistance to the Chicago Transit Authority (CTA), and the city did so. The city identifies a city portion and a CTA portion, with the CTA portion specifically imposed to support CTA's bonds.<sup>52</sup>

Virginia enacted an additional grantor's tax, the regional congestion relief fee, for the Northern Virginia planning district region in 2013 to replace a 2007 regional tax declared unconstitutional by the state supreme court. New York, which has a complex tangle of mortgage taxes, has had a mortgage tax in place for the New York Metropolitan Transportation Authority commuter area since 1969, adding an additional tax on the mortgage in 1987 and raising the rate on the initial tax in 2005.<sup>53</sup>

**States may provide exemptions to vulnerable populations, such as in New Jersey, where the rates are reduced for senior citizens when they sell their principal residence.**

In a similar vein, Nevada associated real estate development with resulting population growth and the need to provide additional public services. In authorizing a higher state transfer tax rate in Clark County, which includes Las Vegas, the Legislature directed that the county's entire local portion of the tax be dedicated to the school district's capital projects. Although the revenue from that tax is not sufficient to fully address the school district's capital needs, the district's dedication to capital projects recognizes the increased pressure on school facilities caused by an expanding real estate market while mitigating the adverse impact of the volatile nature of the tax.

States may provide exemptions to vulnerable populations, such as in New Jersey, where the rates are reduced for senior citizens when they sell their principal residence. Chicago, which has both a city and regional transportation component to its transfer tax, provides a refund of the transit portion of the tax to senior citizens when their principal residence is transferred if they have lived in the house for at least one year and the transfer price is \$250,000 or less. In Ohio, a county's board of commissioners can set a lower transfer tax rate than is otherwise levied for individuals who receive tax deductions for being permanently and totally disabled, 65 years of age or older, or a surviving younger spouse in the specified age range.

Local governments occasionally dedicate their transfer taxes for unique projects. Essex County in New York has had a local transfer tax to fund a public safety radio communications system. In Aspen, Colorado, part of the tax is dedicated to supporting the town's historic opera house, while the rest goes to the housing development fund. In Oklahoma, counties are mandated to collect the mortgage tax and distribute the funds to schools in the county based on average daily attendance.

Some states redistribute collections to localities using formulas that are not proportional to the collections gathered at the local level. Delaware, for example, distributes 25 percent of the yield from the state transfer tax, up to \$8 million, into a special fund for distribution to municipalities and counties in accordance with a formula set out in state legislation.

When overall state revenue declined during the Great Recession and budget gaps developed, states sought to support general operations by diverting dedicated transfer tax revenue.<sup>54</sup> It could be argued that dedicated transfer tax funds are serving as budgetary rainy day funds, which is justifiable when there is a mechanism to replenish the diverted funds to the programs when the state revenue returns to more historic levels.

An example is Maryland, where during the recessions, the state has diverted transfer tax revenue and fund balances from its Program Open Space to the general fund, limiting the state's ability to acquire and improve state parks. Although the state has sought to replace the diverted funds, a good portion of the replacement has come via state authority to issue bonds.<sup>55</sup> While that allows the designated programs to proceed, the long-term impact could have adverse effects on the availability of future dedicated revenue since debt service payments will reduce available revenue for ongoing programs. The District experienced a dramatic decline in revenue during the recession and also diverted funds, even after

<sup>51</sup>City of Seattle Department of Finance, "Special Topic: Real Estate Excise Tax in Seattle," *Economic Update*, at 2 (July 2002).

<sup>52</sup>2008 Ill. Laws 708; 30 ILCS 5/3-2.3(E).

<sup>53</sup>In addition to the mortgage tax for the Metropolitan Transit Authority, the state added the supplemental tax for the support of transportation.

<sup>54</sup>Some of the states that diverted funds were Arkansas, Connecticut, Delaware, Hawaii, Maine, Maryland, New York, and Pennsylvania.

<sup>55</sup>Maryland Department of Legislative Services, "Effect of the 2013 Legislative Program on the Financial Condition of the State" (July 2013).

a modest recovery. Doing so reduced the District's capacity to fund its Housing Production Trust Fund.

### **Conclusion**

Although revenue is volatile and the taxes lack transparency, transfer and mortgage taxes are essential for many states and local governments. While the registration of deeds provides critical information for adequate administration of the property tax, the taxes also generate revenue. In many states, that revenue supports important programs that further land preservation, traffic congestion relief, and housing objectives, mitigating the pressures of real estate development.

Dedicating revenue also offsets some of the negative impact of the volatility of that revenue. As seen during the last recession, only a few states increased the rates on the transfer and mortgage taxes in spite of the dramatic falloff of revenue. Rather, as revenue declined and budget gaps developed, states and the local governments were able to divert the transfer and mortgage tax revenue from their dedicated purposes to the general fund, thus averting larger budgetary crises. Those actions, however, were less than transparent and diluted the objectives of the dedicated revenue.

A modest recovery for the real estate market is underway, and despite the lack of appetite for new or increased transfer and mortgage taxes, those taxes will continue to be a significant factor in many states, especially for housing, outdoor recreation, open space, conservation programs, and, more recently, transportation. That small recovery has already enabled some states to stem the outflow to state general funds from the dedicated funds. However, current conditions will not lead to a quick return to peak funding for programs that depend on transfer and mortgage tax revenue, since the housing market and real estate prices are only slowly recovering and buyers are cautiously reentering the market.