

## Settlement Considerations on Acquisitions of DC Commercial Property – Plan Early and Keep Lines of Communication Open Between Settlement Company and Lender

16 Jan 2020

[Roy L. Kaufmann](#)

The settlement process on commercial transactions and, more particularly, the completion of the FP7/C (Real Property Recordation and Transfer Tax Form) is markedly different than residential transactions. One particular pitfall has recently come to light that has plagued and delayed some transactions and has resulted in more money being due for recordation taxes than the buyer or lender had anticipated. Planning at the early stages of the loan and settlement processes may work towards everyone's advantage.

By way of background, effective October 1, 2019 and expiring on September 30, 2023, the District increased the rate of transfer and recordation taxes on improved or unimproved commercial property (Class 2) if the actual or imputed consideration is greater than \$2 million. The Office of Tax and Revenue issued [OTR Tax Notice 2019-05](#) to provide general information.

The new rates also apply to mixed-use properties if any portion of the property is classified as Class 2, except in rare situations where a homestead deduction has been granted. The new rate imposes a surcharge so that transfer and recordation taxes are each at 2.5%.

Of interest here is calculation of the tax on deeds of trust. In short, there is a recordation tax to be collected on any amount of the deed of trust that is not exempt. For the purposes of calculating the \$2 million threshold for deeds of trust, all debts recorded on the same day, as to the same property, are aggregated and, if threshold is met, the additional tax applies to all deeds of trust.

Keep in mind that, apart from transfer taxes on acquisitions, there is a recordation tax on the deed and a separate recordation tax on the deed of trust, although there may be some applicable exemption. Focusing on the recordation tax on the deed of trust, Part H asks for the Purchase Money Amount of the deed of trust to determine the dollar amounts of the deed of trust that are exempt from the recordation tax.

# JacksCampBlog

Worthwhile Legal News and Comment

(CONTINUED)

SETTLEMENT CONSIDERATIONS ON ACQUISITIONS OF DC COMMERCIAL PROPERTY PLAN EARLY AND KEEP LINES OF COMMUNICATION OPEN BETWEEN SETTLEMENT COMPANY AND LENDER

<b>PARTH- Consideration and Financing</b> <small>"complete all items; insert zero if no amount"</small>		<b>Tax Exemption Application</b> <b>Recordation Tax/Transfer Tax</b> <small>(Cite to Specific DC Code Provision)</small>
<b>I. Deed</b>		
1. Acquisition Price	<input type="text"/>	<input type="text"/> / <input type="text"/>
Cash	<input type="text"/>	<input type="text"/> / <input type="text"/>
Amount of 1 <sup>st</sup> Deed of Trust	<input type="text"/>	
Purchase Money Amount	<input type="text"/>	42-1102(5)
Other Exempt Amount	<input type="text"/>	<input type="text"/>
Nonexempt Amount	<input type="text"/>	

The field Purchase Money Amount is crucial. It seeks to elicit *from the lender*, what portion of its deed of trust is attributable to the acquisition price (as opposed to loan proceeds to be used for construction or other expenses). Only the purchase money component would be exempt. See [DC Code §42-1102](#) which provides:

## § 42-1102. Deeds exempt from tax.

The following deeds shall be exempt from the tax imposed by this chapter:

(1) Repealed;

(2) Deeds to property acquired by the United States of America or the District of Columbia, unless its taxation has been authorized by Congress;

(3) Deeds to real property acquired by an institution, organization, corporation, or government entitled to exemption from real property taxation under [§ 47-1002](#) (or exempt from recordation taxes under a law of the United States of America or the District of Columbia); provided, that, unless waived by regulation, a copy of a filed real property tax exemption application accompanies the deed at the time of recordation; provided further, that this exemption shall not apply to property which is exempt under [§ 47-1002\(2\)](#) or [§ 47-1002\(3\)](#);

(4) Deeds to property acquired by an institution, organization, corporation, or association entitled to exemption from real property taxation by special act of Congress, which property was acquired solely for a purpose or purposes for which such special exemption was granted; provided, that a return, under oath, showing the purpose or purposes for which such property was acquired, shall accompany the deed at the time of its offer for recordation;

(5) A purchase money mortgage or purchase money deed of trust that is recorded simultaneously with the deed conveying the real property for which the purchase money mortgage or purchase money deed of trust was obtained;

The deed of trust, on its face, needs a recitation as to the amount of the purchase money it is securing. See [DC Code §42-1103\(b-1\)\(2\)\(D\)](#) which provides:

(CONTINUED)

## SETTLEMENT CONSIDERATIONS ON ACQUISITIONS OF DC COMMERCIAL PROPERTY PLAN EARLY AND KEEP LINES OF COMMUNICATION OPEN BETWEEN SETTLEMENT COMPANY AND LENDER

- (b)(1)(T) A purchase money mortgage or purchase money deed of trust shall:
- (A) Be fully executed within 30 days of the date that the deed conveying title to the real property to the purchaser is fully executed;
  - and
  - (B) Be recorded within 30 days after the date that the deed conveying title to the purchaser of the real property is duly recorded.
- (2) A purchase money mortgage or purchase money deed of trust submitted to the Mayor for recordation shall:
- (A) Be executed by the purchaser of the real property as part of a series of transactions conveying title to real property to the purchaser;
  - (B) Reference the deed conveying title to the purchaser of the real property by date and instrument number;
  - (C) Recite on the face of the document that it is a purchase money mortgage or purchase money deed of trust; and
  - (D) Recite on the face of the document the amount of purchase money that it secures.

The loan process should begin with an agreement between the lender and the borrower as to what portion of the deed of trust will be attributed to purchase money. The borrower would want that number to be higher, in order to take advantage of the exemption for purchase money.

The lender's preference may be consistent because of the added legal protections for purchase money security interests.

The settlement company needs to keep the lender and the borrower informed. The lender must supply the purchase money dollar amount so that the settlement sheet can be calculated. The lender also needs to insure that the requisite language is printed on the deed of trust (by the way, that applies to all deeds of trust involving purchase money) and the dollar figure in that language must conform to the FP7/C.

If the settlement company does not focus on this element, there may be significant delays in trying to record the commercial deed of trust and the borrower may end up needing to bring more money to the table than anticipated for recordation taxes.

The most current version of the FP7/C must be used (at press time, [the version is 08/2019](#)). If the deed of trust is simultaneous with the acquisition, a single FP7/C may be used to record the deed and the deed of trust. Otherwise, a separate FP7/C must be filed for each deed of trust.

*This summary is not intended to contain legal advice or to be an exhaustive review. If you have any questions about this case or laws impacting real estate in and around the Washington, D.C. region, feel free to contact us. Our [Real Estate Litigation and Transactions Practice Group](#) is ready to assist.*

**TAGGED:** Office of Tax and Revenue, DC Commercial Property, Washington DC Real Estate, OTR Tax Notice 2019-05