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Structuring a tax-exempt refinance transaction

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Are you refinancing a loan that is secured by a building, land or other commercial property? Would you like to save thousands of dollars in recording taxes? By taking the time to properly structure the loan transaction, you may be able to eliminate the payment of $3,300 in taxes for every $1 million that you are borrowing. That would be a $16,500 savings on a $5 million loan.

The Virginia Code imposes a recording tax on deeds of trust (mortgages) at the time that a deed of trust is recorded. The state recording tax is $0.25 per $100 borrowed, and the local tax is an additional $0.0833 per $100 borrowed, with small adjustments made for exceptionally large loans. Needless to say, the amount of recording taxes for any commercial transaction can accumulate very quickly.

In recognition of the fact that it may be unreasonable to charge the same amount of recording taxes when a borrower refinances an existing loan on which recording taxes have already been paid, the Virginia Code exempts borrowers from paying recording taxes - both state and local - upon the recordation of a new deed of trust when the new loan is with the same lender that is the current holder of the lien on the property. The new loan amount must be equal to or less than the amount of the existing deed of trust in order to be fully exempt. However, if the new loan amount is greater than the existing loan, then the transaction would be partially exempt and tax would only be charged on the portion of the loan amount that exceeds the amount on which recording taxes have already been paid on the existing deed of trust.

For example, if your original loan was $1 million and your new loan was $1.5 million, you would only be charged a recording tax on the amount that the new loan exceeds the original, or $500,000.

This statutory exemption works well when your existing lender offers you the best terms for your refinance, but what do you do if you want to switch lenders? Must you pay recording taxes simply because of this change? If not properly structured, the short answer is "yes." A relatively simple solution is to have your new lender become the owner of your existing loan, in which case, the new lender will meet the criteria for the tax exemption for refinancing with the same lender.

The tax exemption provided by the Virginia Code does not discriminate when determining whether the lender holding the lien on a property has been the lender since the existing loan was originated, or whether the lender has only owned the loan for a brief instant. To qualify for the same lender exemption, the new lender must "become" your existing lender at the time that you refinance your loan. This is done by having the new lender "purchase" your loan from your existing lender for the payoff amount on your current loan, and the existing lender would then assign all its interest in the loan to the new lender. Once the existing loan is transferred to the new lender, the new lender becomes the "same lender" at the time the new deed of trust is recorded, and the transaction will be exempt from

recording taxes. The new lender can then refinance or modify your existing loan with a new loan, including using the new lender's form loan documents.

Cooperation is required of both the existing lender and the new lender, and typically you will need counsel to make sure the transaction is structured properly to qualify for the exemption. In addition, the existing lender must deliver the existing original promissory note and deed of trust to the new lender at closing so the ownership of the prior loan is transferred to the new lender, which is one of the reasons this arrangement is not typically used for residential transactions. The additional complexity may lead to higher transaction costs as additional legal documents are necessary to legally transfer the ownership of the loan. However, in many cases, the additional costs are significantly exceeded by the benefits of the recording tax exemption.

This type of refinance transaction may take additional time, and some lenders may not be familiar with the structure, so it is important to have counsel notify both the existing and new lenders as soon as possible that you would like to proceed with this type of arrangement. If approached early in the transaction, most lenders tend to cooperate because they recognize the significant savings involved, even though it is really only the borrower that is benefiting by the additional work.

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