

Government of the District of Columbia

Office of the Chief Financial Officer

Office of Tax and Revenue



April 26, 2023

OTR TAX NOTICE 2023-04

*This Notice Replaces and Supersedes OTR Tax Notice 2014-05
(dated May 21, 2014)*

NOTICE REGARDING THE TAXATION OF
INSTRUMENTS RELATING TO REFINANCES AND MODIFICATIONS

This notice will summarize the District of Columbia recordation tax treatment of refinances and modifications of security interest instruments (*i.e.*, any document evidencing a security interest in real property).

This notice supplements and supersedes OTR Tax Notice 2014-05 by providing generally that, to constitute a refinance, the new loan must be made to the same obligor(s) who was indebted under the loan(s), as modified and restated, if applicable, that is being paid off, extinguished and replaced, and must be secured by the same real property that secured the loan(s), as modified and restated, if applicable, being paid off, extinguished and replaced.

The District's recordation tax law, codified at D.C. Official Code § 42-1103(a)(3)(A), provides generally that, at the time a security interest instrument is submitted for recordation, it is taxed at a rate of 1.45% (except for instruments relating to residential properties transferred for a consideration less than \$400,000, which are taxed at a rate of 1.1% or instruments secured by class 2 property, which are taxed at 2.5% through September 30, 2023) of the total amount of debt incurred that is secured by the interest in real property; provided, that if the existing debt is refinanced, the rate shall be applied only to the principal amount of the new debt in excess of the principal balance due on the existing debt to the extent that such existing debt (including any prior debt that was previously refinanced by the existing debt) was:

- (i) Previously taxable under this paragraph and the tax thereon was timely and properly paid; or

(ii) Exempt under § 42-1102 or not otherwise taxable, including purchase money mortgages described in § 42-1102(5).

The recordation tax law, codified at D.C. Official Code § 42-1103(a)(3)(B), further provides that any amendment, modification, or restatement of a security interest instrument shall be deemed a refinance of the entire aggregate debt owed, unless the amendment, modification, or restatement is a supplemental deed. With such a deemed refinance, the tax rate shall be applied only to the principal amount of the modified debt (including amounts paid to the borrower on the existing security interest instrument during the preceding 12 months) in excess of the principal balance due on the existing debt (before any such payment) to the extent that the existing debt (including any prior debt that was previously refinanced by the existing debt) was:

(i) Previously taxable under this paragraph and the tax thereon was timely and properly paid; or

(ii) Exempt under § 42-1102 or not otherwise taxable, including purchase money mortgages described in § 42-1102 (5).

The current version of the statute governing taxation of refinances and modifications was initially enacted as emergency legislation on June 19, 2012. Fiscal Year 2013 Budget Support Emergency Act of 2012, subtitle L, title VII, D.C. Act No. 19-383. The provisions of this emergency legislation apply to documents presented for recordation beginning June 19, 2012. The emergency act was supplanted by permanent legislation incorporating identical provisions. Fiscal Year 2013 Budget Support Act of 2012, subtitle L, title VII, D.C. Law No. 19-168.

Refinances

Under the applicable legislation, when any security interest instrument that reflects a refinance transaction is presented to the Recorder of Deeds (ROD) for recordation, such instrument shall be taxed on the excess of the principal (face) amount of the refinance instrument over the principal balance due on the existing debt under the prior security interest instrument. The principal balance of the existing debt is exempt from tax only to the extent that any tax due on the existing debt (including any prior debt that was previously refinanced by the existing debt) was paid or the existing debt (including prior debts) was exempt from taxation. If tax was due but not paid on the existing balance or any portion thereof, such balance or portion will be taxed when the refinance instrument is presented for recordation.

The foregoing tax shall not apply to transactions concerning certain residential property containing 5 dwelling units or less, and for which a Security Affidavit - Class 1, ROD Form 21, is on file; a security interest instrument concerning such property is fully exempt (*See* D.C. Official Code § 42-1102(21)).

A refinance is limited to a new loan which is used to pay off, extinguish and replace an existing loan(s) (whether with the original or a new lender) that is (1) made to the same obligor(s) who was indebted for each of the loan(s), as modified and restated, if applicable, being paid off and who was the grantor(s) of each of the security interest instrument(s), as modified and restated, if applicable, securing each of the loan(s) being paid off and replaced and (2) secured by the same real property as secured the loan(s), as modified and restated, if applicable, being paid off and replaced. The sale or assignment of a security interest instrument from one lender to another on the secondary market, where there are no changes in the terms or conditions provided in the instrument and the borrower has taken no action to refinance, is exempt from the recordation tax. (*See* D.C. Official Code § 42-1102.01).

For purposes of determining whether a transaction is a refinance, the obligor(s) who is indebted for the loan(s), as modified and restated, if applicable, being paid off and replaced and who is the grantor(s) of the security interest instrument(s), as modified and restated, if applicable, securing such loan(s) at the time that the loan(s) is paid off and replaced must be the same as the obligor(s) who is indebted for the replacement loan and is the grantor(s) of the security interest instrument securing the replacement loan. Guarantors or sureties are not taken into account for this purpose. An entity which has converted to another form in a transaction entitled to exemption under D.C. Official Code § 42-1102(22) is considered to be the same obligor before and after the conversion.

Separate loans (as to each of which all obligor(s) and grantor(s) are the same for each loan as stated in the preceding paragraph) may be simultaneously refinanced with a single new loan to such obligor(s) and grantor(s) if all of the real property(ies) securing the loans being paid off and replaced is the sole security for the replacement loan.

If a single loan is used to pay off and replace more than one existing loan, refinance treatment is not available unless the obligor(s) who is indebted for the loan(s), as modified and restated, if applicable, being paid off and replaced and who is the grantor(s) of the security interest instrument(s), as modified and restated, if applicable, securing such loan(s) at the time that the loan(s) is paid off and replaced is the same as the obligor(s) who is indebted for the replacement loan and who is the grantor(s) of the security interest instrument securing the replacement loan. Refinance treatment is not available unless the real property(ies) securing the new loan are the same as the real property(ies) securing the loan(s), as modified and restated, as applicable, being paid off and replaced.

Because refinance treatment is applied on a loan-by-loan basis, a single new loan which is not by itself sufficient to completely pay off an existing loan does not qualify for refinance treatment, even if it is incurred simultaneously with another new loan(s) which are, when all such new loans are combined, sufficient to pay off the existing loan.

Modifications

The legislation further provides that, when a security interest instrument that reflects a modification, amendment or restatement of an instrument is presented for recordation, it shall be taxed on the excess of the principal (face) amount of the modified instrument (including amounts paid to the borrower on the existing security interest instrument during the preceding 12 months) over the principal balance due on the existing debt (without including any such payments). The principal balance of the existing debt is exempt from tax only to the extent that any tax due on the existing debt (including any prior debt that was previously refinanced by the existing debt) was paid or the existing debt (including prior debts) was exempt from taxation. If tax was due but not paid on the existing balance or any portion thereof, such balance or portion will be taxed when the modified instrument is presented for recordation.

A modification generally occurs when the terms of a pre-existing security interest instrument are changed in some manner, but the obligation imposed by the preexisting instrument is preserved and the loan secured by that instrument it is not paid off, extinguished or retired. A supplemental instrument which modifies a prior recorded instrument without additional consideration is not taxed. (*See* D.C. Official Code § 42-1102(6)).

Substantiation of Taxable Amount and Entitlement to Exemption

When a security interest instrument (including a supplemental instrument) reflecting a refinance or modification of debt is offered for recordation, the following documentation is to be provided as an attachment to the Form FP 7/C, Real Property Recordation and Transfer Tax Form to substantiate an exemption claim and facilitate computation of the tax.¹

In order to substantiate that a transaction is a refinance, at the time a security interest instrument is submitted for recordation, documentation must be provided showing that the obligor(s) who is indebted for the loan(s), as modified and restated, if applicable, being paid off and replaced and who is the grantor(s) of the security interest instrument(s), as modified and restated, if applicable, securing such loan(s) at the time that the loan(s) is paid off and replaced is the same as the obligor(s) who is indebted for the replacement loan and who is the grantor(s) of the security interest instrument securing the replacement loan. Substantiation must also be provided showing that the real property(ies) securing the new loan is the same as the real property(ies) securing the loan(s), as modified and restated, as applicable, being paid off and replaced.

¹ These substantiation requirements do not apply to security interest instruments exempt from recordation tax under D.C. Official Code §§ 42-1102(3) (generally relating to deeds to property entitled to exemption from real property tax under D.C. Official Code § 47-1002) or (21) (generally relating to a security interest instrument in residential property with no more than 5 dwelling units that is accompanied by a security interest affidavit (ROD Form 21) when submitted for recordation).

For both refinances and modifications, a statement must be provided showing the outstanding principal balance of the existing debt, as well as the principal (face) amount of the debt as refinanced or modified. In the case of modifications, the statement must show the amount of any funds paid to the borrower during the 12 months preceding the date that the modification is submitted for recordation and the outstanding principal amount of the existing debt without including those amounts. If no such payments were made, a statement to that effect is to be included in the attachment. All supporting Forms HUD-1 and loan payoff statements must accompany the statement.

In addition, to substantiate and claim credits for any previously paid taxes or exemptions on prior security interest instruments with respect to refinances or modifications of debts that were secured by such instruments, the statement shall also list the instrument number, date of recordation, the prior exemption claimed (if applicable), and (if not exempted) the amount of recordation tax previously paid as indicated by the stamp on the prior instrument. In addition, the security instrument shall recite on its face that it is a refinance or modification deed of trust (as applicable), and make reference to the instrument or document number of the prior instrument being refinanced or modified.

Tax will be imposed on the outstanding balance of the existing debt to the extent that a claim of credit or exemption is not properly substantiated.

Due to the enactment of legislation specifically addressing the tax treatment of refinances and modifications, any guidance previously issued by the Office of Tax and Revenue on these subjects (including OTR Tax Notices 2012-01 and 2014-05) is hereby superseded.

Please direct all questions or comments related to this Notice to the Office of the Recorder of Deeds, at 1101 4th Street, SW, 5th Floor, Washington, DC 20024, or call (202) 727-5734.