

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION

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CLERK OF
SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA
TAX DIVISION

565860 FLORIDA AVENUE, L.L.C.

v.

Tax Docket No. 7632-98

DISTRICT OF COLUMBIA

MEMORANDUM OPINION AND JUDGMENT

This tax assessment appeal presents an issue of first impression in the Superior Court. The controversy herein concerns a property that was sold in foreclosure while still encumbered by two unsatisfied notes. The purchaser was the same entity that held the notes. The issue is whether recordation and transfer taxes may be assessed lawfully based upon the deficiency amount that remained unpaid after the foreclosure sale, where the successful bidder did not contract to pay such debt. Without question, the sum on which the taxes were calculated herein was substantially greater than the amount of money that was actually paid for the property as a result of the foreclosure auction. The taxpayer was forced to pay such taxes and was denied a refund.

As a practical matter, the District contends that the Recorder of Deeds properly assessed the taxes based upon the outstanding mortgage liability that previously had encumbered the property. The District further argues that extinguishment of the buyer's own

deed of trust note somehow represents quantifiable "consideration" that was actually paid for the property in the foreclosure sale. This argument is an alternative theory, in comparison with a very different reason that was explicitly given by the Recorder of Deeds as to the reason for denying the refund. It is apparent that the District cannot support the explicit basis on which the refund was denied.

The issue presented requires the Court to interpret the meaning and application of a specific statute. There are no appellate cases directly on point. The Court must interpret what the relevant statute means and what the Recorder of Deeds is actually authorized and required to do. The decision herein also requires analysis of the basic legal concepts that apply to foreclosure sales and the meaning of a deficiency sum.¹

The court has heard oral argument on the Cross-Motions for Summary Judgment. Based upon the following analysis, this Court concludes that the taxpayer must prevail.

Nature of the Taxes In Dispute: In order to place this assessment appeal in a useful context, it is important to recapitulate certain basic concepts about the nature of these taxes

¹As far as the foreclosure auction is concerned, the scenario in the instant case was not weird or unusual. There is nothing improper about lenders bidding on properties after having extended loans secured by such properties. Because this is a common scenario, it is not clear why the issue herein has never been litigated in the Superior Court until now. However, this Court will not be diverted by speculation. The Court takes the case as the Court finds it.

and the method that is prescribed by statute for assessing them.

The explicit reason for imposing recordation and transfer taxes is "to defray the approximate cost of operating the Office of the Recorder of Deeds." D.C. Code § 45-915(b) (1981). The purpose of these taxes is not to assess the fair market value of the realty. For the sake of clarity, the Court pauses to emphasize that the District's basic system for taxing fair market value of real property is embodied in regular assessments that were formerly rendered on an annual basis, but which are now issued every three years. This process is completely separate from that of the imposition of recordation and transfer taxes as to one discrete transaction, such as a sale of realty.

The exclusive formula for assessing recordation taxes is found in the District of Columbia Code. It provides, "At the time it is submitted for recordation, a deed that conveys title to real property in the District shall be taxed at a rate of 1.1% of the total consideration for the deed. [emphasis supplied]" D.C. Code § 45-923(a) (1981). The formula for assessing transfer taxes is also found in the Code. The law states, "There is imposed on each transferor for each transfer at the time the deed is submitted to the mayor for recordation a tax at the rate of 1.1% of the consideration for such transfer; provided, that in any case where application of the rate of tax to the consideration for the transfer results in a total tax of less than \$1 the tax shall be \$1." D.C. Code § 47-903.

Further details and definitions are set forth in the Code as

to what figures shall be used as the basis for calculating these two taxes. When a property is sold, the deed

shall be accompanied by a return under oath in such form as the Mayor may prescribe, executed by all the parties to the deed, setting forth the **consideration for the deed or debt secured by the deed**, the amount of tax payable, whether the property to which the deed or document refers is a residential real property as defined in § 47-1401, the instrument number and date of any prior recorded supplemental deed, and such other information as the Mayor may require so as to provide an accurate and complete public record of each transfer of residential real property.

D.C. Code § 45-923(b) (1981) [emphasis supplied].

More precisely, the Code specifies the definition of "consideration." This term "means **the price or amount actually paid, or required to be paid**, for real property, including any mortgages, liens, encumbrances thereon, construction loan deed of trust or mortgages or permanent loan deeds of trust or mortgages."

D.C. Code § 45-921(5) (1981) [emphasis supplied].

The District also directs the Court's attention to regulations that define "consideration" as what is "actually paid or ultimately required to be paid for real property, whether that consideration is in the form of cash or is in some other form." 9 D.C.M.R. §§ 502.4 and 602.2 (May 1996). These regulations, however, do not add any criteria that are not readily embraced in the Code definition.

Uncontested Material Facts of Record: This case does not involve a factual dispute. The judgment herein exclusively turns on the legal interpretation of the formula by which the recordation

and transfer taxes are to be assessed where, as here, the auction purchaser is the same party that previously held outstanding notes secured by the realty. For purposes of adjudicating the instant Motions, it is useful to recapitulate those facts that are uncontested and which are essential for just adjudication of the issues.

1. The taxpayer herein (a limited liability company) had previously purchased two notes that were secured by the subject property. Those delinquent notes had a combined outstanding value of \$309,847.21. The property was a building known as 52 Quincy Place, N.W. in the District of Columbia.

2. On March 1, 1996, the taxpayer purchased the subject property at a public auction for the price of \$10,000.00 (ten thousand dollars). This was the taxpayer's bid. There were no other bidders.

3. When the taxpayer attempted to record the new deeds, the Recorder of Deeds assessed the transfer and recordation taxes based upon a total valuation of \$309,847.21. The amount on which the taxes were calculated is the sum of the outstanding loan balances, not the purchaser's bid that was accepted by the Trustee. The holder of the outstanding loans is the same entity that bought the property in foreclosure, i.e. the taxpayer herein.

4. As a prerequisite to this tax appeal, the Petitioner paid all taxes that were assessed by the Recorder of Deeds, i.e. \$6814.00.

5. A refund of \$6594.00 with interest is demanded herein by

the taxpayer, and the refund was denied previously by the Recorder of Deeds.

6. The Trustee's return that accompanied the deed in this case reflected that the only sum "paid or required to be paid" for the property was the discrete amount of \$10,000.00. The Trustee's return did not report any mortgages, loans assumptions, promises, or any other type of obligation that was to be secured by this property or which was part of the consideration which the taxpayer contracted to pay. A copy of the Trustee's return is found in the court record as Exhibit 8 attached to the Petitioner's Motion for Summary Judgment.

7. The Trustee's return is typed. However, it bears the handwritten figures that were added at the insistence of the Recorder of Deeds subsequent to the auction. On its face, the return bears handwritten changes in the block denominated as "Consideration and Financing." The handwritten changes included the substitution of the sum of \$304,847.21 as "outstanding note consideration." The taxes due were changed accordingly, also through handwritten modifications to this typed form. All such handwritten changes were made as a requirement of the Recorder of Deeds. The taxes were then calculated based upon the Recorder's views as to what should be included on the return, rather than on the amounts that were reported under oath on the return by the Trustee.

8. When the taxpayer demanded a refund of the overpayment of taxes, the letter issued by the Office of Tax and Revenue supplied

the reason for the denial of refund. This letter is found in the court file as Exhibit 11 attached to the Petitioner's Motion for Summary Judgment. In this letter of April 2, 1998, the Recorder of Deed denied the refund stating in pertinent part: "D.C. Code, section 45-924 and section 47-904, when the consideration paid for real property is nominal, recordation and transfer taxes are imposed upon the fair market value. At the time of recordation, this property was assessed at \$420,100.00 for which the stated consideration of \$10,000.00 is clearly nominal. Accordingly, your claim for refund is denied."

Relevant Case Law: A proper analysis of this case turns in part upon a correct understanding of the significance of a deed of trust, as well as a solid understanding of what happens at a foreclosure sale. In any event, taxes should not and cannot be calculated upon the personal whim of the Recorder of Deeds. There must be a firm legal basis for the assessment of any tax.

The law of the District of Columbia is quite transparent as to the nature of a deed of trust that is not satisfied at a foreclosure sale. The deed of trust is not a guarantee that the note-holder will receive payment of the entire amount borrowed. At best, the deed of trust only provides the lender with the priority opportunity to have a Trustee sell the property for the highest bid. Once that process has ended, the lender must accept the result -- which could be a substantial loss. However, the lender still may sue the borrower for the deficiency amount. See Finley

v. Friedman, 159 A.2d 668, 670 (D.C. 1960).

The aftermath of a foreclosure sale may or may not result in the original lender being made whole. Many scenarios may emerge. For example, the original borrower may be judgment-proof, or the property may have become substantially devalued over time prior to the foreclosure. This could happen in any given situation because of accidents, vandalism, or economic market forces.

The District of Columbia Court of Appeals has ruled that the remedies of suing on a note and foreclosing on property that secures the note are independent remedies and do not conflict with each other. A creditor "may seek both a judgment against a maker or guarantor of the deed of trust note and a foreclosure (judicial or non-judicial) pursuant to the deed of trust, and may do so in any sequence." Szego v. Kingsley Anyanwutaku, 651 A.2d 315, 318 (D.C. 1994). In Szego, the Court of Appeals held that the trial court erred in concluding that the appellants were precluded from pursuing foreclosure based upon the doctrines of res judicata, collateral estoppel, and election of remedies." Id.

Adjudication of the Issue: There are two levels on which this Court must analyze the merit of the Petitioner's case.

The taxpayer and the District describe the issue in different semantical terms. However, this is not critical to the merits of the issues. The taxpayer couches its appeal in terms of seeking relief from a "denial of refund." The District argues that a Superior Court tax appeal is a de novo proceeding and, thus, the

Court should not focus on the merit of what was contained within the four corners of the Recorder's letter to the taxpayer. Instead, the District argues, this Court should focus only on the question of whether the Recorder lawfully assessed a tax "deficiency."

These labels reflect a distinction without a real difference, because the operative facts of what the Recorder did in denying the refund are the same underlying facts that comprise the "assessment." Thus, under either rubric, the real legal debate is the same. For the sake of completeness, the Court will evaluate the literal reason for the denial of the refund, as well as the District's more recent justification for the denial.

1. The Recorder's Letter of Denial.

As a threshold matter, this Court has already ruled upon the lack of merit in the Recorder's stated reason for denial of the refund. In a published opinion, this Court discredited in great detail the notion that money paid for a property in foreclosure can be ignored as "nominal" simply because the purchase price is lower than the alleged fair market value of the property. Askin v. District of Columbia, Tax Docket No. 5572-93, 123 D.W.L.R. 156 (Super. Ct. August 14, 1995). For the sake of brevity, this Court will incorporate herein by reference its analysis set forth in Askin. However, certain parts of this Court's ruling should be emphasized, for purposes of helpful comparison.

In Askin, the taxpayer had purchased a number of condominium

units for the price of \$5,000.00 each. The sale was not a foreclosure sale. Rather, the condominium was selling off units that could not command the expected price on the open market. In identical fashion to what happened in the instant case, the Recorder of Deeds ignored the actual purchase price. The Recorder insisted upon assessing the recordation and transfer taxes on the basis of what the Recorder deemed to be the fair market value.

This Court ruled in Askin that there was no statutory authority whatsoever for assessing taxes in this manner, i.e. based upon the Recorder's subjective opinion that the price had been "nominal." In other words, this Court outlawed exactly the same procedure that the Recorder invoked in the instant case.

The District of Columbia never appealed this Court's ruling in Askin.

It is striking that the Recorder of Deeds nonetheless continued to assess these taxes in the same way, totally ignoring the Court's decision. Indeed, the instant case represents an act that is essentially in contempt of the Superior Court. The decision in Askin was filed on April 19, 1995 and published in the Daily Washington Law Reporter on August 14, 1995. Yet, the Recorder of Deeds repeats the same illegal decisions in the instant case through his letter of April 2, 1998. Without doubt, the Recorder's act had been found to be lacking lawful authority before the foreclosure sale herein had ever taken place.

2. The District's Theory of "Consideration" Evidenced by Extinguishment of the Lien.

It is apparent that the District searches for a way to justify the tax assessments herein, knowing that the explicit reason given for the denial of a refund is legally defective.

As an alternative theory, the District contends that when the taxpayer's own lien was effectively extinguished by the foreclosure sale, the taxpayer somehow provided the value of the outstanding mortgage amount as the real consideration for the deed. The Recorder of Deeds arbitrarily substituted the deficiency amount as the "consideration," despite the Trustee's sworn return indicating that the sole consideration was the sum of \$10,000. The Recorder did not even add the \$10,000 as part of the consideration.

Upon close analysis, the Court concludes as a matter of law that the District's theory lacks merit.

There are several factors that expose the faulty nature of the District's position.

One, the deficiency of what was still owed on the original mortgage is certainly not an amount of money that the taxpayer was required to pay itself in order to obtain title to the property. If anyone other than the taxpayer had been the successful bidder, no other party would have been required to give debt in exchange for the deed, e.g. required to assuming responsibility for completing payments on the note. In fact, in any foreclosure sale, if the sale does not generate enough revenue to satisfy a lien, the note-holder who took the deed of trust as security can still pursue the original borrower for the balance that is owed.

The District of Columbia Court of Appeals long ago observed,

"It makes no difference that both a note and deed of trust are executed; a creditor can have but one satisfaction, and after a foreclosure sale the proceeds must be applied to payment of the debt leaving the note actionable for the deficiency only." Finley v. Friedman, supra, 159 A.2d at 670.

Two, the Recorder of Deeds had no legal authority to substitute his own opinion for that of the sworn return of the Trustee, as to what constituted the actual consideration.

To be sure, the Code does prescribe that where a loan is secured by the property being purchased, the information about such debt must be reported in the Trustee's return following a sale. This is precisely the source from which the Recorder of Deeds learns what consideration was given for the Deed. Yet, in the instant case the Recorder presumed to re-write history.

It is the Trustee, not the Recorder of Deeds who certifies the elements of the transaction. This is the whole purpose of the Trustee's return. The Recorder is not empowered to re-write the contract of sale. Yet, this is exactly the essence of what the District seeks to justify.

The Court pauses to note that the Code provides that fair market value may be used to assess recordation and transfer taxes in only one situation, i.e. when "no price or amount is paid or required to be paid for the real property or for the transfer of an economic interest in real property or where the price is nominal . . . [emphasis supplied]" D.C. Code § 45-924(a) (1981). Clearly, however, these are not the facts herein. There was a specific

purchase price of \$10,000.00, which is manifestly not nominal.

The District refuses to recognize a rather fundamental principle, i.e. that the party who determines what is "required to be paid" is the seller. The bidder who is able to buy a property in a foreclosure sale need only submit the highest bid -- and nothing more.

Even the Trustee cannot "require" more consideration than what is proposed in the winning bid. Manifestly, then, the Recorder cannot do so.

Insofar as the holder of the notes herein was the "seller," the law would not require this party to pretend that it received full payment of the notes simply because it purchased the property. After all, a lender in foreclosure typically does not want the property. The lender realistically wants the sum of money that is owed. Purchasing the property at auction only results in a third possibility, i.e. that the lender one day might resell the property if a suit for money is unsuccessful.

Three, objectively, the Code itself recognizes that consideration and debt secured by a deed are different -- and should not be confused. The Code requires that the return must identify "the consideration for the deed or debt secured by the deed" D.C. Code § 45-923 (1981) [emphasis supplied]. Obviously, consideration paid and "debt secured by the deed" are two different items that may be reported on the Trustee's return. The Code itself speaks of them as separate matters. If the transaction itself does not explicitly call for the use of the

property as security for a loan, then a previously outstanding loan balance from some other sale is not part of the consideration paid for the deed in the present sale.

Finally, the Court will pause to consider the District's novel argument that the "merger" of the estates of the lender and the foreclosure purchaser resulted in additional consideration for the deed. The District argues that the term "consideration" should be interpreted to include the very same money that the foreclosure failed to produce. The District relies upon a unique theory that the "estates" of the mortgagor and mortgagee "merged," when the lender bought the property as a bidder.

The District contends that the "merger" signifies a form of consideration, ostensibly on the theory that extinguishment of the lien represents the victory of having obtained the value of the unpaid mortgage balance. The District builds this argument upon a Maryland case that is distinguishable from the facts in the instant case. The District relies upon Warfield v. Christiansen, 93 A.2d 560 (Md. 1953).² This case warrants close scrutiny only because the District perceives that it is pivotal.

In Warfield, an individual extended a mortgage secured by a house. This individual later died and left the note as an asset of his own estate. The income from this note was distributed to his widow. The persons who originally had purchased the house conveyed the property to the widow, making her the owner of the house

²Although Maryland law is not controlling, the common law of Maryland can be instructive where there is no District of Columbia case law on point.

itself.

Important language is found in the deed for this transaction. This deed contained the following provision: "'This conveyance, however, is made **subject to a certain duly recorded mortgage**, executed by Dorsey B. Stout and Gertrude Stout, his wife. The party of the second part, by the acceptance of this deed, **does hereby assume the said mortgage** and relieves the parties of the first part from the payment thereof and all obligations thereunder.'" Id. at 561 [emphasis supplied]. When the widow died, her daughter inherited the house and later sold it to someone else.

Eventually, despite a chain of subsequent resales of the house, the decedent's estate of the widow still owned the note as a receivable. The fiduciary of the widow's estate attempted to collect payments from the last purchaser in the chain. This last purchaser resisted the obligation to assume payments on the note and did not prevail in the Court of Appeals of Maryland. The reason for this result is instructive in the instant case, but does not support the District's position.

The Maryland appellate court reasoned that because the conveyance to the widow explicitly recited that the conveyance was being made "subject to" the mortgage, the mortgage had not been extinguished in any way and was still payable as a lien on the realty. Id. at 562. The appellate court recognized, "Where a conveyance is made subject to a mortgage, the amount due on the mortgage is presumptively a part of the consideration for the

purchase." Id. This principle does no harm to the Petitioner herein, because this taxpayer's bid did not contain any contractual agreement to purchase the deed by giving any debt or assuming the obligations under the mortgage.

The principle that emerges from Warfield does not help the District of Columbia. If anything, it supports the Petitioner when it is read in full context. The following further analysis is important.

In Warfield, the Court relied upon the concept that the role of the outstanding mortgage is subject to contractual terms within a deed. If the provisions within the deed recite that the sale is "subject to" the mortgage, then the outstanding mortgage is clearly "consideration" for the sale. However, if the contract of sale or the deed does not contain this agreement, then the outstanding sum due on the mortgage would not be "consideration" for the sale. This analysis fits very precisely with the principle that when a sale extinguishes a mortgage, the disappointed lender may still pursue other remedies against the defaulting borrower. In effect, the District seeks to erect a special exception that only applies to the original lender as a foreclosure purchaser. There is no basis in law for such an exception.

As the appellate court in Warfield noted, "the acquisition of the equity of redemption in mortgaged property by the mortgagee results in a merger of the two estates, vesting the mortgagee with the complete title **and putting an end to his rights under the mortgage.**" Id. at 562 [emphasis supplied]. A reference to

"putting an end" to rights under the mortgage certainly does not mean that the lender in fact has been fully repaid the amount of the loan. This is the fiction that the District now attempts to use in order to justify the assessment herein.

It is important not to inflate a deed of trust beyond what it really is. It is vehicle to a possible remedy -- but no more. It is a vehicle through which the lender acquires priority to force a sale that may or may not satisfy the existing loan. This is a risk with any deed of trust.

The mere fact that the original lien has been extinguished by the foreclosure does not mean that anyone actually paid the full balance of the note as consideration for the deed. It also does not guarantee or signify that anyone "ultimately" will ever pay to the original lender the full deficiency amount. Yet, this is the conceptual fallacy that underlies the District's position in the instant case.

In conclusion, the concept of merger of estates as applied in Warfield, is mis-used by the District.

The District's position, whether or not the District will acknowledge it, seems to be fueled by the perplexing or annoying reality that this property was sold at a bargain price. The same theme pervaded the record in Askin. The Recorder of Deeds was simply struggling for a way to tax more than an apparent bargain price, but could not lawfully do so. This case merely represents another version of the arbitrariness displayed in Askin.

The Court concludes as a matter of law that the assessment

herein was made totally afoul of applicable law and that the District owes this taxpayer the refund that was demanded. Insofar as the Recorder of Deeds imposed a so-called "deficiency assessment," such assessment is unlawful. The denial of the request for refund was completely unjustified.

In the final analysis, where the Code speaks of "actual" consideration, that term means what it says. It does not denote an amount of money that is figurative or metaphysical.

WHEREFORE, it is by the Court this 8th day of August, 2000

ORDERED that the Petitioner's Motion for Summary Judgment is hereby granted; and it is

FURTHER ORDERED that the District of Columbia's Cross-Motion for Summary Judgment is hereby denied; and it is

FURTHER ORDERED that the District of Columbia shall refund to the Petitioner the sum of \$6,594.00 plus interest at the statutory rate until paid. Such interest shall accrue from the docketing date of the instant order.


Cheryl M. Long
Judge

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