

REALTY TRANSFER TAX BULLETIN 2009-01

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MORTGAGES, MORTGAGE FORECLOSURES AND MORTGAGE ASSIGNMENTS

The Department is issuing this Bulletin to address the application of the Pennsylvania Realty Transfer Tax to mortgages, mortgage foreclosures and mortgage assignments.

This Bulletin addresses issues raised in Private Letter Ruling RTT-04-016, and revises the Department's policy regarding those issues. Consequently, this Bulletin supersedes Private Letter Ruling RTT-04-016, which has been rescinded.

Section 1. General Rule

Documents that effectuate or evidence the conveyance of title to real estate located in Pennsylvania are subject to Realty Transfer Tax, unless the document is excluded or exempt from tax by statute. 72 P.S. § 8102-C.

Section 2. Mortgages

Under Pennsylvania law, a **MORTGAGE** is a written instrument that both conveys and creates a security interest in real estate. "A mortgage is in essence a defeasible deed, requiring the grantee to reconvey the property held as security to the grantor upon satisfaction of the underlying debt or the fulfillment of established conditions." Hahnemann Medical College & Hospital v. Com., 416 A.2d 604 (Pa. Cmwlth. 1980). Hereinafter, the term **MORTGAGE** means both the mortgage instrument and the security interest that it creates. The term **MORTGAGE INSTRUMENT** means the mortgage instrument itself. The term **MORTGAGE INTEREST** means the security interest in the real estate created by the mortgage. The term **MORTGAGOR** refers to the person who grants a mortgage interest in real estate. The party that holds the mortgage interest is referred to as the **MORTGAGEE**.

Even though a mortgage creates a defeasible conveyance of title to real estate, for Realty Transfer Tax purposes, a taxable document does not include "mortgages, deeds of trust or other instruments of like character given as security for a debt and deeds of release thereof to the debtor." 72 P.S. § 8101-C (definition of "document"). Department regulations provide that a "conventional mortgage or assignment, extension, release or satisfaction thereof" is not a taxable document. 61 Pa. Code § 91.101.

The Department has interpreted the statutory exclusion applicable to mortgages to include any instrument that is akin to a mortgage if the instrument is given as

security for a debt as part of a "financing transaction." 61 Pa. Code § 91.193(b)(23). A financing transaction is an "arrangement in which the following apply:"

- (i) Realty is transferred by the debtor solely for the purpose of serving as security for the payment of a debt.
- (ii) No sale or gift is intended.
- (iii) The debtor retains possession and beneficial ownership of the real estate transferred before default.
- (iv) The transferee obtains title or ownership to the real estate only so far as is necessary to render the instrument of transfer effective as security for the debt.
- (v) The transferee or the transferee's successor is obligated to return the transferred real estate at no or only nominal consideration to the debtor upon payment of the debt before default.

61 Pa. Code § 91.101 (definition of "financing transaction"). A "sale and leaseback" is an example of a transaction that may qualify as a financing transaction under certain circumstances. 61 Pa. Code §§ 91.168 and 91.193(b)(23); *see also Hahnemann*, 416 A.2d 604 (Pa. Cmwlth. 1980).

A mortgage is generally accompanied by a **PROMISSORY NOTE** or **NOTE** (in older practice, a bond and warrant). The note is evidence of the debt obligation for which the mortgage is given. The mortgage and the note, while separate instruments, secure the same debt. However, the note is a personal obligation of the obligor (mortgagor). A judgment on the note permits the obligee to execute on the personal property of the obligor as opposed to just the real estate encumbered by the mortgage. Ronald M. Friedman, Ladner Pennsylvania Real Estate Law §§ 22.01 and 25.04 (5th ed. 2006).

Section 3. Mortgages in Default and Mortgage Foreclosures

Although a mortgage itself is not a taxable document, certain real estate transactions associated with a mortgage in default or a mortgage foreclosure can have Realty Transfer Tax consequences.

Some mortgagors who are in default of their mortgage loan convey the mortgaged real estate to the mortgagee in lieu of requiring the mortgagee to foreclose on the real estate. Such a deed given in lieu of foreclosure is a document that would be subject to Realty Transfer Tax as explained in Section 1, above. However, a statutory exemption exists for such a deed. See Section 4, below.

In a mortgage foreclosure action,¹ the sheriff exposes the mortgaged real estate to sale for the benefit of the mortgagee and the mortgagor. If the mortgagee is a

¹ See Pa. R.C.P Nos. 1141-1150.

successful bidder, the sheriff is required to execute a deed for the real estate to the mortgagee. Pa. R.C.P. No. 3135. The sheriff's deed conveying title to the real estate as the result of a mortgage foreclosure is a document that would be subject to Realty Transfer Tax as explained in Section 1, above. However, a statutory exemption exists for such a deed. See Section 4, below.

Section 4. Realty Transfer Tax Exemptions for Transfers to Mortgagees

Realty Transfer Tax is not imposed upon a document that effectuates a transfer of title to real estate from "a mortgagor to the holder of a bona fide mortgage in default in lieu of a foreclosure or a transfer pursuant to a judicial sale in which the successful bidder is the bona fide holder of a mortgage." 72 P.S. § 8102-C.3(16).

The above statutory provision provides for two tax exemptions related to the transfer of title to real estate to a mortgagee—(1) a transfer from a mortgagor in default in lieu of foreclosure to a mortgagee, and (2) a transfer to a mortgagee who is a successful bidder at a judicial sale of the mortgaged real estate. Each exemption applies to a transfer of title of real estate to a mortgagee when the mortgage is in default—either by a mortgagor in lieu of foreclosure or by a sheriff under a judicial sale. Further, the transfer must be to a person who holds the mortgage interest in the real estate. As explained in Sections 5 and 6 below, the mortgagee can be different from the party of record named in the mortgage instrument.

Although the Realty Transfer Tax law provides exemptions for a transfer to a mortgagee, there are restrictions on the exemptions.

When there is a transfer of title to real estate from a mortgagor to a mortgagee, the transfer is only exempt if the mortgagor is "in default" of the mortgage loan and the transfer is in "lieu of foreclosure." Consequently, it is the Department's position that there must be evidence that the mortgagor is in default of the terms of the mortgage loan, which default would permit the mortgagee to foreclose on the mortgage. Otherwise, the conveyance cannot be considered to be in lieu of foreclosure. A default is not limited to a failure to remit mortgage payments. It can also include any other failure to comply with a mortgage term that would allow the mortgagee to foreclose on the mortgage loan. Evidence of default that is acceptable to the Department includes the actual filing of a mortgage foreclosure action or written notice from the mortgagee to the mortgagor of the mortgagee's intent to foreclose.

In order for the exemption related to transfers from a sheriff to a mortgagee as the result of a judicial sale to apply, the deed of conveyance from the sheriff must be executed in favor of the mortgagee who held the mortgage interest at the time of the sale and who made the bid at the sale (or for whose benefit the bid was made). The exemption does not apply if the mortgagee assigns the mortgage or bid to another person after the bid is made and the sheriff executes the deed in favor of the assignee. Id.

In determining the imposition of tax on a sheriff's deed directly to a mortgagee's assignee, the Department will look to 61 Pa. Code § 91.170(b) and treat the deed as representing two transactions. Tax will be due on the single deed as if both transactions had been effectuated by separate documents. The first transaction will be deemed to be a conveyance from the sheriff to the mortgagee. This transaction is exempt from tax. 72 P.S. § 8102-C.3(16). The second transaction is a conveyance of the real estate from the mortgagee to the assignee. This transaction is taxable. If consideration is given for the assignment and the assignment is at arms-length, then the conveyance is a sale and the sale price is the taxable value. 61 Pa Code § 91.132. The sale value includes the amount paid for the assignment plus any obligation assumed by the assignee (such as the sheriff sale bid.) If there is no consideration or the assignment is not at arms-length, then the assignment is not considered a sale and the computed value of the real estate is the taxable value for the second transaction. 61 Pa. Code § 91.135(1).

The above explanation should not be misconstrued to suggest that the tax exemption only applies if the sheriff's deed conveys the real estate to the original lender/mortgagee. Any valid assignment of the mortgage interest prior to the bid at the foreclosure sale does not affect the exemption, even if the assignment is made after the mortgage foreclosure action is initiated. An assignment of the mortgage interest prior to the sheriff sale and entry of the bid makes the assignee the mortgagee entitled to claim the exemption. Any conveyance from the sheriff to the mortgagee is exempt from tax. However, any person who becomes an assignee of the mortgage interest after the bid is made is not a mortgagee to which the exemption applies. This rule is intended to prevent a mortgagee from disguising what is in substance a transfer of real estate from the mortgagee to the assignee, where the mortgagee is otherwise a small step away from consummating its purchase of and title to the real estate at the sheriff sale.

Section 5. Mortgage Assignments

A. Assignments Historically

"As a general rule, mortgages are freely transferable by the mortgagee under the covenants, terms and conditions set forth in the mortgage document as are mortgage notes, bonds, or any other underlying obligation for which the mortgage is given as collateral. Traditionally, mortgages were not assigned as a matter of course. . . . In modern practice, a great number of mortgages are assigned from the original mortgagee to an investor or servicing agent. . . . Often mortgages may be assigned more than one time during the term of a mortgage with the mortgagor remitting payments to a succession of mortgage holder-assignees." Ladner § 26.01(a).

"An assignment is usually done by an instrument called an assignment of mortgage, which is a writing under seal, signed, acknowledged and recorded, assigning the bond or promissory note and mortgage to the assignee. An assignment, when duly executed and acknowledged, should be recorded. It will then have all the incidents and force of a public record and is notice to any subsequent assignee. . . ." Ladner § 26.01(d) (emphasis added). Although an assignment generally includes an assignment of both the note and the mortgage, Pennsylvania law provides that ". . . ,

an assignment of the bonds [or promissory note], whenever made, carries with it all of the security provided for by the mortgage and all the right, interests, and remedies of the mortgagee.” Andrews v. The Marine National Bank of Erie, 33 A.2d 75, 78 (Pa. Super. 1943) (*citing* 19 Corpus Juris Secundum § 1192). “So, if the bond or note is assigned, the mortgage is presumed to go with it.” Ladner Pennsylvania Real Estate Law § 26.01(d). Consequently, an assignment of the note alone is sufficient to convey the mortgage interest even if the mortgage instrument and the mortgagee named therein remains unchanged. The purchaser of the note, thus, becomes the new mortgagee. The original mortgagee named in the mortgage instrument remains on the mortgage instrument in name alone and is no longer the mortgagee.²

B. Modern Practice of Assignment by Sale and Negotiation of the Promissory Note

Many lenders do not assign a mortgage by assigning the mortgage instrument. Rather, they sell the mortgage interest by negotiating the promissory note. The lender sells the promissory note in a secondary mortgage market, most often to one of the government or government-sponsored entities created by statute to purchase residential mortgage loans from banks and other lenders. See 12 U.S.C. §§ 1451-1459, 1716-1723 et seq. (creating the Government National Mortgage Association ("Ginnie Mae"), Federal National Mortgage Association ("Fannie Mae"), and Federal Home Loan Mortgage Corporation ("Freddie Mac")). In turn, these entities resell notes in a tertiary mortgage-backed securities market, usually as part of a bundle of notes held in trust for investors. As a result, the beneficial owners of these promissory notes can be thousands of investors whose identities change as these negotiable instruments are sold and resold in these markets, and as the investors sell and resell their shares in the mortgage-backed securities. For Realty Transfer Tax purposes, when a note is held in trust for investors of mortgage-backed securities, the trust (or more specifically, the trustee of such trust) is deemed to hold the mortgage interest associated with the note, not the individual investors who merely have invested in the mortgage-backed securities.

A lender who sells a note may contract with the note purchaser to become a servicer of the mortgage loan for the note purchaser. A **SERVICER** provides a fee-based service for lenders/mortgagees which service includes: billing borrowers; collecting, monitoring and reporting loan payments; remitting loan payments to the lender; receiving, holding and disbursing tax and insurance escrows; and foreclosing on defaulted loans. When a lender sells a note and retains the servicing rights, the lender continues to be the mortgagee in the recorded mortgage instrument in order to remain the party to receive service of process related to the mortgage.

² This is not to suggest that the mortgagee of record is not entitled to service of process and other legal rights of a mortgagee of record. It merely indicates that the mortgagee of record no longer holds the mortgage interest and is not considered the mortgagee for purposes of the tax exemption.

In the alternative, the lender may decide, in addition to selling the note, to sell the servicing rights to another party through a purchase and sale agreement. In that case, the lender assigns the mortgage instrument to the purchaser of the servicing rights, which assignment is recorded in the land records. Thus, the purchaser of the servicing rights becomes the named mortgagee on the recorded mortgage instrument. Nonetheless, the servicer is the mortgagee in name only. The true mortgagee is the owner of the note.

Sales of servicing rights may occur multiple times over the life of the mortgage loan requiring numerous assignments of the mortgage instrument from one servicer to the next. Regardless of whether the original lender acts as the servicer or whether the servicing rights to a mortgage loan are sold to another party, a servicer is never considered a mortgagee for Realty Transfer Tax purposes. See Section 7 for a further discussion of servicers.

C. Effective Date of Assignment

For purposes of determining the effective date of a mortgage assignment, the Department looks to the date the written assignment agreement is executed by the parties or the date the written assignment agreement indicates that the assignment becomes effective, whichever date is later. The date that the parties enter into talks or negotiations related to the assignment of a mortgage has no bearing on the date the assignment is effective.³ Therefore, the Department will generally disregard evidence of talks, negotiations and oral agreements when a written assignment agreement exists.

One exception to this rule is when a written assignment agreement merely memorializes an existing oral assignment agreement. In that case, the Department will accept the effective date of the oral agreement as the effective date of the assignment.⁴ However, the written agreement must indicate by express terms that it

³ An arrangement of terms, in contemplation of a written contract, is not a perfect agreement upon which an action can be maintained, but to produce such effect, it must be shown by acts or declarations of the parties that they intended the agreement to be operative before execution and without regard to a writing. Thus, where an intention is manifested in any way that legal obligations between parties shall be deferred until a writing is executed, preliminary negotiations and agreements do not constitute a contract, and where the parties making a parol agreement contemplate a subsequent reduction of the terms to writing, the parol agreement alone is not enforceable without showing an intention that it should become operative before the execution and without regard to the writing. 12 P.L.E. 2d Contracts § 28 (footnotes omitted).

⁴ Legal obligations, however, can arise out of a contract whose terms are definitely agreed upon, notwithstanding that the parties understood that a formal contract was subsequently to be executed, and where the parties agree orally to all the terms of a contract between them and part of their mutual understanding is that a written contract embodying such terms shall be drawn and executed by them, the oral contract may be enforced, even

merely memorializes a prior oral agreement and must provide the date the oral agreement was effective. If it does not, the Department will not accept parol evidence to prove the existence of a prior oral agreement.

When the parties do not execute a written assignment of the mortgage instrument but merely assign the mortgage interest by selling and negotiating the promissory note, the Department looks to the date the promissory note is negotiated to determine the effective date of the assignment.

Section 6. Mortgage Electronic Registration System (MERS)

There has been a recent trend to track mortgage assignments and sales of servicing rights electronically. The Mortgage Electronic Registration System (MERS) was created for this purpose.

MERS is a national electronic registry system, owned and operated by MERSCORP, Inc. (MERSCORP). It became operational in 1997.

Lenders who are members of MERS designate MERS to act as their nominee and to become the nominal mortgagee listed in the mortgage instrument.⁵ A **NOMINEE** is someone who acts on behalf of another. As such MERS is the party named in the mortgage instrument, but the mortgage interest remains with the lender. MERS is made the nominal mortgagee in one of two ways. Under the first method, the lender assigns its mortgage to MERS by a written assignment agreement. Under the second and more common method, MERS receives the mortgage as the Original Mortgagee of Record (MOM).⁶ In other words, at the loan closing, the borrower directly executes the

though one of the parties thereafter refuses to execute it. Moreover, even though the parties to an oral agreement contemplate that it is to be reduced to writing and signed, if the understanding is that this is to be done simply as a memorial of the agreement, the contract is binding, notwithstanding that it is never put to writing, and such a contract is obligatory from the date of the making of the oral agreement. 12 P.L.E. 2d Contracts § 28 (footnotes omitted).

⁵ More specifically, Mortgage Electronic Registration System, Inc. (MERS, Inc.), a subsidiary corporation of MERSCORP, is named the nominal mortgagee.

⁶ A sample of the language contained in a mortgage in which MERS, Inc. is named as the nominal mortgagee is as follows:

“MERS” is Mortgage Electronic Registration Systems, Inc. MERS is a separate corporation that is acting solely as a nominee for Lender and Lender’s successors and assigns. MERS is the mortgagee under this Security Instrument.

* * *

This Security Instrument secures to Lender: (i) the repayment of the Loan, and all renewals, extensions and modifications of the Note; and (ii) the performance of Borrower’s covenants and agreements under this Security Instrument and the

mortgage instrument with MERS as the nominal mortgagee for the lender and the lender’s successors and assigns. The lender is named as the payee under the promissory note.

By either method, MERS becomes the nominal mortgagee of record in the county land records. The MERS member registers the mortgage on the MERS System. After MERS becomes the nominal mortgagee of record, recording future assignments of the mortgage interest or servicing rights from one MERS member to another is not required because MERS remains the nominal mortgagee of record.

Mortgage and servicing rights are not transferred on the MERS System. In other words, the MERS System does not effectuate the electronic transfer of rights. The MERS System only tracks the changes in servicing rights and ownership of mortgage interests. Servicing rights are sold via a purchase and sale agreement. Mortgage interests are sold via endorsement and delivery of the promissory note. These are non-recordable events.

The MERS System is designed to serve only its members. Therefore, if servicing rights or a mortgage interest is sold to a non-MERS member, then a paper assignment must be executed and the mortgage will be transferred to the non-MERS member. MERS cannot remain the nominal mortgagee for a non-MERS member.

A mortgagee who is a member of MERS may decide to have MERS foreclose on the mortgaged real estate on the mortgagee’s behalf.

For Pennsylvania Realty Transfer Tax purposes, when MERS is acting as the nominal record mortgagee, the Department will consider MERS to be a mere agent acting on behalf of the mortgagee. The holder of the original or negotiated promissory note, as the case may be, is the mortgagee.

Section 7. Application of Pennsylvania Realty Transfer Tax

Determining whether the RTT exemptions discussed in Section 4, above, are applicable to a particular situation is difficult given the frequency that real estate loans and mortgages are sold and the number of actors involved in real estate lending that can have some interest in or responsibility related to the note and mortgage. The actors can include: banks, savings associations and other lending institutions, loan and mortgage originators, brokers and servicers, common trust funds, warehouse lenders, wholesale lenders, retail lenders, and document custodians.

Note. For this purpose, Borrower does hereby mortgage, grant and convey to MERS (solely as nominee for Lender and Lender’s successors and assigns) and to the successors and assigns of MERS, the following described property located in the _____ of _____ :

In order for one of the realty transfer tax exemptions discussed in Section 4 to apply, it is imperative to identify the mortgagee. Normally, this will be the party named in the original mortgage instrument or, in the case that the mortgage is assigned, the assignee of the mortgagee. In the case where the promissory note securing the mortgage loan is negotiated, the owner and holder of the note is the mortgagee. In the case where the record mortgagee is a nominal mortgagee, such as MERS, the mortgagee is the original lender holding the promissory note, or in the case of an assignment, the assignee of the note.

Subsidiary Corporations and SPEs. A subsidiary corporation, special purpose entity (SPE) or other business entity of the mortgagee is not the mortgagee. For Realty Transfer Tax purposes owners of business entities are separate and distinct from the business entities themselves. 72 P.S. § 8102-C.4. Therefore, a deed from a mortgagor or sheriff to a mortgagee's subsidiary corporation, SPE or business entity is not exempt from tax.

Servicers. A loan servicer is never considered a mortgagee. As stated above, the mortgagee must be the party that holds the mortgage interest in the real estate. A servicer holds the servicing rights to the mortgage loan and acts on behalf of the mortgagee for purposes of administering and collecting the mortgage loan. Those rights have nothing to do with the incidents and ownership interest in the real estate or the security in the real estate. Consequently, a person acting solely as a servicer can never be the mortgagee. Nonetheless, as previously discussed, a servicer might stand in the position of a nominal mortgagee of record for purposes of receiving service of process related to a mortgage loan and, as such, may initiate foreclosure proceedings on behalf of the actual mortgagee. To that extent, a servicer can be considered as a nominal mortgagee as discussed below.

Deeds in lieu of Foreclosure. Any deed executed by a mortgagor to a mortgagee, whether the original mortgagee or assignee, in lieu of foreclosure is not subject to tax as explained in Section 4.

Foreclosures and Judicial Sales. Any deed executed by a sheriff as the result of judicial sale in a mortgage foreclosure action to a mortgagee is not subject to tax as described in Section 4.

Nominal Mortgagees. In the event that a nominal mortgagee, such as MERS, takes title to real estate secured by a mortgage on behalf of the mortgagee, the deed to the nominal mortgagee will not be subject to tax. The nominal mortgagee stands in a position of an agent of the mortgagee. Any transfer to an agent is treated as a transfer to the principal. 72 P.S. § 8102-C.3(11)(ii), 61 Pa. Code §§ 91.193(b)(11) and 91.153(b)(2). In this case, the principal is the mortgagee. Consequently, the deed to the nominal mortgagee is exempt from tax. Further, any subsequent conveyance from the nominal mortgagee to the mortgagee is exempt from tax as a conveyance from an agent to a principal as long as the conveyance is for no or nominal consideration. See 72 P.S. § 8102-C.3 (11), 61 Pa. Code §§ 91.193(b)(11) and 91.153(a)(1).

In the case where the nominal mortgagee takes title to the real estate on behalf of the mortgagee, the conveyance is exempt from tax as explained above. However, if the mortgagee thereafter assigns its right to receive the real estate from the nominal mortgagee to another party, the conveyance from the nominal mortgagee to the assignee is subject to tax.

Documentation and Evidence. In all cases, it is the burden of the party claiming the tax exemption to prove that the exemption is applicable to the particular transaction. Any person claiming the exemptions explained in Section 4 must make sure that they have adequate documentation to demonstrate the applicability of the exemption claimed. Such documentation includes the actual note and mortgage securing the obligation and identifying the mortgagee. In the case where the mortgage has been assigned, then it is imperative for the assignee to have possession of and be able to produce the assignment documents—either the written assignment agreement and/or the note that has been negotiated to the assignee. In the event that a nominal mortgagee, such as MERS, takes title to the real estate, documentation must exist that evidences that the nominal mortgagee is taking title to the real estate on behalf of the mortgagee. Without such documentation to substantiate the identity of the mortgagee and the date on which the mortgagee obtained the mortgage interest, the Department can disallow the exemption and assess tax on the transaction.

Recording. Whenever a taxpayer files a document with the Recorder of Deeds to which the taxpayer believes an exemption explained in Section 4 is applicable, the taxpayer must file a statement of value with the document to claim the exemption. A copy of the instrument by which the mortgagee obtained its mortgage interest should be submitted with the statement of value. Without the submissions of such documentation with the statement of value, the Recorder is authorized to reject the document for recording without the proper amount of tax being paid and remitted.

Even if the above procedure is followed and the Recorder accepts a deed for recording, nothing in this Bulletin shall be construed to limit the Department's authority to investigate any document or transaction, deny an exemption or assess tax due the Commonwealth.