

## WHAT DOES THE DOCUMENTARY TAX TELL US?

The basic goal in the purchase of an investment property for profit is to uncover a property having a high fair market value with a low amount of debt. The difference between fair market value and debt is equity---and the greater the equity, the greater the value of the investment. Finding a property with high equity can be a daunting effort for any investor. There are a few tools, however, that can help.

Prior to buying a foreclosure property at a trustee's sale, the investor must carefully examine the debt that accompanies the property at the time of purchase. At the sale, the high bidder agrees to pay the amount necessary to pay off the foreclosing loan---with the tacit understanding that all debt secured by the property and recorded prior to the date of recording of the foreclosing loan becomes part of the total debt accompanying the purchase of the property. So, carefully examining title and debt prior to the date of recording of the foreclosing loan is a critical part of the "due diligence" required by every investor.

It would seem apparent that the debt secured by the property begins with the date of recording of the grant deed by the seller on behalf of the new buyer and follows chronologically as each debt is recorded after that date up to the date of recording of the foreclosing loan..

I wish it were that easy!

Unfortunately, the possibility exists that prior debt securing the property exists in the seller's name (or another's name) while the seller owned the property. Should this be true and the investor assumed that all debt securing the property would be in the name of the new buyer (now defaulted owner), that investor would miss part of the debt accompanying the purchase of the property at a trustee's sale. The county government, however, has a neat little package that helps us uncover the possibility of debt in other than the current owner's name. It is called the Documentary Transfer Tax.

Counties operate under a state charter that gives them the right to tax equity given by the seller to the buyer at the rate of \$0.55 per \$500 of equity transferred. Emphasis should be given to the fact that the transfer tax does not apply to debt transferred from the seller to the buyer.

The Documentary Transfer Tax Declaration normally is given on the upper right hand corner of the first page of the recorded grant deed. Although each county may adjust the wording to it's own needs, the following data is given: a) The amount of the county transfer tax, b) a place to check if the tax was "computed on the full value of the interest of the property conveyed", or c) a place to check if the tax was "computed on the full value less the value of liens or encumbrances remaining thereon at the time of sale". Sometimes, an additional place to check is given if the transfer is exempt and the reason for that exemption. Exemptions for the tax are given include a "gift", "liened to full

value”, or “exempt under Revenue and Taxation Code \_\_\_\_”. Some counties also require the person determining the tax to sign the document.

It turns out that the existence of a documentary transfer tax can tell us three things: a) that a transfer of real property occurred (including where and when), and b) whether taxable equity was transferred from the seller to the buyer.

We would prefer to buy the properties that show a “full value” grant deed---that is, a grant deed that shows that only equity was transferred from the seller to the buyer. Then, there is no debt in another’s name to complicate the total debt that exists on the property when the defaulted owner bought the property from the seller. If debt in someone else’s name was transferred to the defaulted owner, the documentary transfer tax would show that the transfer included debt and equity with the transfer. The tax would be computed only on the equity part of that transfer.

To complicate things a bit, it is possible to compute the debt that may have accompanied the transfer of ownership from the seller to the defaulted owner by examining the records for the seller back to his/her “full valued” grant deed, and finding all the deeds of trust that were recorded against that seller that were not paid off as noted by the recording of a matching reconveyance deed. The remaining debt should be the debt transferred by the seller to the defaulted owner. In real life, I would add that this is much too complex and fraught with scary assumptions about what amount of debt actually was transferred by the seller. Even the remaining principal due on such debt could only be approximated.

Personally, I am most comfortable with a careful search for the “full value” deed property with no scary exemptions. I expect the debt recorded between the grant deed and the date of recording of the foreclosing trust deed to give me a true picture of the debt to be absorbed by the high bidder. Documents recorded after the date of recording of the foreclosing loan can have an impact on loan priorities, and some documents recorded after that same date can add a high degree of uncertainty for the high bidder at the trustee’s sale---so “ya just gotta be careful—ya hear?”

911 words

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Topic: How the Documentary Transfer Tax helps us define equity