Coates' Canons Blog: Property Tax Foreclosures: Attorneys' Fees and Interest

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Foreclosure is a powerful collection remedy of last resort for property taxes that are a lien on real property. Because property tax liens generally have super-priority, local governments almost always get paid first from the proceeds of a foreclosure sale. That preferred priority for tax liens also means the mere threat of a foreclosure action will often prompt mortgage lenders to pay the delinquent taxes because their (usually much larger) mortgage liens will be extinguished by a foreclosure sale.

Foreclosure can be very effective, but local governments must remember that once a foreclosure action begins—meaning once a complaint is filed or a judgment is docketed—the local government loses all other collection remedies for the taxes included in the foreclosure. G.S. 105-366(b). If a foreclosure sale fails to produce enough funds to satisfy the delinquent taxes, interest and costs included in the foreclosure, the unpaid amounts will never be collected. With this limitation in mind, tax collectors need to pick their foreclosure targets wisely and avoid properties that are unlikely to produce sufficient sale proceeds.

I've previously blogged about the tax foreclosure process in general (here and here), about what taxes should be included in a foreclosure, and about setting opening bids. Today I focus on two issues that continue to generate lots of questions: when and how attorneys' fees and interest should be collected in property tax foreclosures.

Attorneys' Fees

The Machinery Act is clear about when attorneys' fees may be charged to a taxpayer: only after a complaint has been filed in a "mortgage-style" foreclosure. G.S. 105-374(i).

If the local government is using the "in rem" foreclosure process under G.S. 105-375, no attorneys' fees may be charged to the taxpayer. The in rem process permits the taxpayer to be charged only an administrative fee of $250 to cover any legal, paralegal, or similar work necessary to proceed with the foreclosure. The local government is authorized to add that fee to the taxpayer's account when it creates and sends the required notice of foreclosure under G.S. 105-375(c)(5).

In a mortgage-style foreclosure under G.S. 105-374, the attorneys fees cannot be added to the taxpayer's account unless and until a complaint is filed. If the foreclosure is terminated before a complaint is filed, no attorney fees may be charged to the taxpayer. From what I've heard, more than a few local government violate this rule and inappropriately charge taxpayers for the time spent by attorneys to send warning letters prior to filing foreclosure complaints.

Here's the type of story I've heard: assume Billy Blue Devil is delinquent on 2013 and 2014 taxes on his home in Carolina County. The county retains the law firm of Dewey, Cheatham & Howe to prosecute a foreclosure action against Billy. The law firm first sends Billy a letter warning him that unless he pays the delinquent taxes within 30 days the county will foreclose on his home.

After getting the warning letter Billy hustles over to the tax office and offers to pay his taxes. The tax office tells him that the file has been transferred to the foreclosure attorney and Billy must talk with that attorney to pay off his delinquent taxes. An angry Billy then drives to the offices of Dewey, Cheatham & Howe where he is told not only must he pay his taxes but he must also pay attorneys' fees of $150.

I see two problems with this scenario. First, I don't think a tax office is ever authorized to refuse to accept a payment from a taxpayer. If Billy wants to pay off his delinquent taxes, I think he should be permitted to do so at the tax office regardless of what collection remedies are underway. Second, the county cannot force Billy to pay attorneys' fees because no foreclosure complaint has been filed. Dewey, Cheatham & Howe can of course negotiate with the county a fee for its work

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on Billy's case, but neither the law firm nor the county can pass that fee along to Billy.

Once a foreclosure complaint is filed, the county is permitted to charge the taxpayer "one reasonable attorney's fee." G.S. 105-374(i).

Assuming the foreclosure makes it to sale, the "commissioner" (usually the county's attorney) should deduct the attorneys' fee from the sale proceeds prior to paying any taxes or other liens on the property. G.S. 105-374(q). The attorneys' fee is in addition to the 5% fee authorized for the foreclosure sale commissioner. G.S. 105-374(i).

The attorneys' fee is also chargeable to the taxpayer if the foreclosure is terminated after the complaint but prior to sale by payment of all amounts owed on the property. (Remember that anyone can make this payment and stop the foreclosure; that option is not limited to the taxpayer.) In this scenario, the county and the attorney must confer on the updated accounting of all amounts owed including taxes, interest, costs (advertising, publication, filing fee, etc.), and attorneys' fee before telling the taxpayer the final amount that must be paid to terminate the foreclosure.

In either case, if the taxpayer thinks the attorneys' fee is too high he or she can ask the court to review it for "reasonableness." The local government itself may need to obtain a court order approving the attorneys' fees in cases where the taxpayers insists on paying only the taxes and interest.

What is a reasonable attorneys' fee for a tax foreclosure? That depends on a lot of factors, including the number of parties with interests in the property and the complexity of the required title search. My property tax friends across the state tell me that their foreclosure attorneys' fees usually range between $1,500 and $2,500 per case.

Interest

The Machinery Act requires that interest accrue on delinquent taxes and all related costs (advertising, bad check fees, etc.) from the delinquency date (January 6 of the fiscal year for which the tax was levied) at a rate of 2% for the first month and .75% for every subsequent month. G.S. 105-360. Interest generally continues until all of the principal taxes and costs have been paid.

In a foreclosure, the local government must provide to the court a final accounting of taxes and costs owed by the taxpayer well before those taxes and costs are paid by the sale proceeds. In a mortgage-style foreclosure, this accounting occurs when the attorney files the required certificate of taxes owed. G.S. 105-374(e). In an in rem foreclosure, this accounting occurs when the judgment is docketed. G.S. 105-375(b). Each type of accounting should include Machinery Act interest accrued to the date the accounting is filed or docketed.

It might be months or years from that date until a foreclosure sale is confirmed and the local government actually receives payment. Should interest continue to accrue on the delinquent amounts during that period?

The in rem statute provides a clear answer: post-judgment interest of 8% per year applies accrues until the sale is confirmed. G.S. 105-375(d). But the mortgage style statute (G.S. 105-374) doesn't address post-judgment interest. Some local governments don't bother collecting any interest after the judgment is issued. The practitioners I've spoke with think that interest should continue to accrue but disagree as to how that interest should be calculated and collected. In my view, post-judgment interest of 8% should apply to "regular" foreclosure judgments just as it does to in rem judgments and all other judgments.

One approach is to continue to accrue Machinery Act interest and to inform all bidders at the foreclosure sale that the purchaser will take the property subject to the additional Machinery Act interest that has accrued since the certificate of taxes owed was filed or the judgment was docketed with the court.

The better approach is to terminate Machinery Act interest as of the date of judgment but to accrue "post-judgment" interest on those amounts up to the date the sale is finalized. The attorney would then pay to the county the post-judgment interest from the sale proceeds along with taxes, Machinery Act interest, fees, and costs. Post-judgment interest runs from the date of judgment to payment of the judgment at an annual rate of 8%. G.S. 24-1 and 24-5(b).

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These two different approaches result in (slightly) different amounts of interest being collected from different taxpayers.

Assume that Billy Blue Devils' house in Carolina County is sold at a foreclosure sale by Carolina County and that Billy owed a total of $1,000 in taxes, costs, attorneys' fees, etc. Carolina County's attorney files the certificate of taxes owed on May 1, 2015 for $1,000 and the court immediately issues a judgment for that amount. The foreclosure sale is finalized on September 1, 2015 for a final bid of $10,000.

Under the Machinery Act approach, the county would accrue an additional 4 months of Machinery Act interest (June, July, August and September) at .75% per month, a total of 3%, on the $1,000 that is owed. That works out to $30 in additional Machinery Act interest. The high bidder would take ownership of the property subject to a lien for the $30 in additional Machinery Act interest. The property would also be subject to the lien for 2015 taxes which was not able to be determined at the time of judgment because the county had not yet set its 2015 tax rate.

Under the post-judgment interest approach, the county would accrue 121 days (May 1 to September 1) of 8% per annum post-judgment interest, which works out to $26.40 in additional interest. The attorney would subtract this additional interest from the sale proceeds prior to paying the other taxes and costs owed on the property. Similar to above, the property would be sold subject to the lien for 2015 taxes.

I recommend that tax foreclosure attorneys use the post-judgment interest approach because I think it more accurately reflects the somewhat ambiguous Machinery Act guidance on this issue.

The Machinery Act explicitly states that in a tax foreclosure sale the property must be sold free and clear of all taxes that can be accurately determined at the time of judgment. G.S. 105-374(k) and G.S. 105-375(i). The term "taxes" is defined in to include interest. G.S. 105-273(15). This leads me to conclude that the property must be sold free and clear of all liens for all amounts owed for the tax years included in the foreclosure, including interest.

In the Billy Blue Devil example, the property was sold for 2013 and 2014 delinquent taxes. I think the Machinery Act demands that the property be sold free and clear of liens for all amounts owed for 2013 and 2014, including interest.

Of the two approaches described above, only the post-judgment interest approach satisfies the Machinery Act's requirement of a sale free and clear from all liens relating to the tax years included in the foreclosure sale.

Regardless of which approach attorneys use, they should take great care to make clear to bidders what tax liens, if any, will remain on the property after the tax foreclosure sale.

Links

- canons.sog.unc.edu/?p=1094
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-366
- canons.sog.unc.edu/?p=1944
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