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## Coates' Canons Blog: Tax Foreclosure Tips

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Article: <https://canons.sog.unc.edu/tax-foreclosure-tips/>

This entry was posted on July 28, 2011 and is filed under Finance & Tax, Property Taxes

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As the economy continues to drag, more and more local governments are relying on foreclosures to improve their tax collections. I've blogged previously about the foreclosure process here and here. Today's post responds to a couple of interesting questions attorneys and tax officials have raised in recent weeks. But first, a few general observations and reminders.

Foreclosure is available as a collection remedy for property taxes that are liens on real property and for any obligation owed to a local government that can be collected as property taxes, including solid waste fees (when billed with property taxes), ambulance and EMS fees, special assessments, nuisance abatement costs, and minimum housing standard enforcement costs.

Foreclosure is *not* available to collect other taxes levied by local governments such as privilege license taxes, occupancy taxes, or prepared food/meal taxes, unless the taxing unit first sues the delinquent taxpayer and obtains a judgment for back taxes. For more details on these other taxes and fees, take a look at this bulletin.

When foreclosing for unpaid property taxes, be sure to include all taxes owed on the real property itself *plus* all taxes owed on personal property (other than registered motor vehicles) listed by the taxpayer in the same taxing unit. If Billy Blue Devil lists for taxation in Carolina County both Parcel A and a boat, then the tax lien on Parcel A includes the taxes on that parcel plus the taxes on the boat. Carolina County has the option of foreclosing on Parcel A if Billy fails to pay either the taxes on that parcel or the taxes on his boat. In other words, Billy could lose Parcel A for his failure to pay taxes on his personal property. This rule does not apply to taxes on registered motor vehicles, which are never a lien on real property.

Once a foreclosure complaint is filed (under NCGS 105-374's "mortgage style" procedure) or a foreclosure judgment is docketed (under NCGS 105-375's "in rem" procedure) all other Machinery Act remedies against the taxpayer's personal property must end. If the Carolina County tax office has an ongoing wage attachment against Tommy TarHeel for delinquent 2009 taxes, the tax office must terminate that attachment if and when it files a foreclosure complaint or docketed a foreclosure judgment for the same taxes. The tax office cannot wait until the actual foreclosure sale occurs, which might be months later.

When the sale date arrives, remember that the taxing unit has no obligation to set a minimum opening bid. Most often, the taxing unit will start the bidding at amount equal to all of the taxes, interest, and costs owed on the property being foreclosed. But the taxing unit should do so only if it is willing to become the proud new owner of the foreclosed property. By setting a minimum bid, the taxing unit is in fact bidding that amount. And if no one else bids, the town will be required to buy the property at its opening bid.

To learn more about the foreclosure process, check out this bulletin. Here are a few interesting foreclosure questions I've received in the past few weeks that didn't make it into that bulletin.

### 1. What amount must the high bidder pay at the foreclosure sale?

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If the taxing unit is the high bidder, NCGS 105-376(b) permits the taxing unit to pay only that amount of the bid that would *not* be distributed to it and to other taxing units for taxes, interests and costs owed in the property. In other words, the purchasing taxing unit must pay at the close of the sale only those costs and fees owed to third parties, usually the court and the attorney. If the taxing unit later sells the property, it can reimburse itself for those costs before sharing the proceeds with other local governments that had property tax liens on the property.

But what if a third party is the high bidder? For mortgage-style foreclosures under NCGS 105-374(m), the most a high bidder can be required to pay immediately is a deposit of 20%. Veteran tax foreclosure attorney Mark Bardill reports that he requires the 20% deposit in cash or certified check within 30 minutes of the sale's conclusion.

The Machinery Act doesn't provide the same explicit guidance for in rem foreclosure sales. Such sales much be conducted by the sheriff "in the same manner as other real property is sold under execution." NCGS 105-375(i). Execution sales are governed by Article 29B of NCGS 1. Other than requiring that the sale be for cash, Article 29B offers no instructions as to what the sheriff should or may require from the high bidder on the day of sale. I think this means that counties can adopt whatever reasonable payment procedures they desire.

Kimberly Mullinax, Cleveland County's experienced in rem specialist, reports that they apply the deposit rules for upset bids to the initial sale. The high bidder must immediately pay \$750 or 5% of the bid, whichever is greater. Orange County's in rem expert Valerie Curry reports that for years the county required only a 10% deposit on the day of sale. But after seeing too many high bidders walk away from their deposits (especially when the sales involved low-value properties), the county changed its approach. High bidders are now required to pay the full amount of their bids in cash by 3pm of the day of sale, which usually gives the bidders several hours to pull together the money. I think both of these approaches are perfectly legal and appropriate.

## 2. What taxes can be included in the foreclosure sale?

Under either type of tax foreclosure, the actual sale will take place months after the process begins. During this lag time quite often additional taxes on the property will be levied or become delinquent. From the taxing unit's perspective, it is ideal to include these additional taxes in the foreclosure sale so that they can be paid and the property can be sold free and clear of all tax liens. But this result is not always possible, meaning the buyer may take title to the property subject to tax liens that were not included in the foreclosure.

The mortgage-style procedures in NCGS 105-374(e) permit the taxing unit to allege liability for "subsequent taxes" in its initial foreclosure complaint. If this allegation is included in the complaint, then just before obtaining a judgment ordering sale the taxing unit should include in the request for judgment all taxes that are lien on the property. The judgment is not limited to taxes that are delinquent. The only taxes that cannot be included (and therefore will remain a lien on the property in the hands of the buyer) are those that "the amount of which has not been definitely determined." The request for judgment should also include interest at the standard Machinery Act rate of .75% per month for all of the delinquent taxes included the foreclosure up through the expected date of sale.

For example, assume that Carolina County is foreclosing on Wanda Wolfpack's real property for delinquent 2009 property taxes. The foreclosure complaint is filed in December 2010 and includes an allegation of subsequent taxes. When the county moves for a judgment ordering sale in August 2011, the 2010 taxes remain unpaid and delinquent. Although the 2011 county budget and tax rate has been set, the 2011 taxes have yet to be billed and are of course unpaid. Carolina County should include in its request for judgment taxes from all three years, 2009, 2010, and 2011, because all three years of taxes are a lien on the property as of the judgment date. The request for judgment should include interest on the 2009 and 2010 taxes through the expected date of sale. There would be no interest on the 2011 taxes because they are not yet delinquent.

If instead the county seeks judgment in May 2011 prior to the adoption of the 2011 budget and tax rate, then the 2011 taxes could not be included in the foreclosure sale because they could not definitely determined at that date. The property would be sold subject to the lien for 2011 taxes.

NCGS 105-375 does not offer a similarly clear resolution to the issue of subsequent taxes. The in rem process offers no opportunity to update the amount of taxes owed after docketing the judgment. However, the statute permits the judgment

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to include all taxes that are a lien on the property as of the docketing date. I think this means the tax office can (and should) include more recent taxes in the judgment even if those taxes are not yet due or delinquent.

Consider the Wanda Wolfpack example again. If Carolina County docket its in rem judgment in December 2010, I think that judgment should include both the delinquent 2009 taxes and the not-yet-delinquent 2010 taxes on the property. The 2011 taxes could not be included in the judgment, and therefore could not be part of the foreclosure, because they were not yet a lien on the property. The property would be sold subject to the 2011 taxes after the taxing unit obtains an execution at least two months later. NCGS 105-375(i).

A quick note about interest for in rem foreclosures. Tax collectors should be sure to include in the docketed judgment Machinery Act interest on the delinquent taxes up to the date of docketing. However, docketing the judgment ends the accrual of Machinery Act interest on the delinquent taxes. From the date of docketing until the date of sale, the total amount owed by the taxpayer will accrue post-judgment interest at a rate of 8% per year. NCGS 105-375(d). At sale, the tax office should add interest to the total amount owed (which might include taxes that are not yet delinquent) at the 8% annual rate.

Finally, local governments using the in rem process should remember that as of July 1, 2011, the administrative charge that can be added to the taxes owed increased from \$50 to \$250. S.L. 2011-352. The new charge applies to all in rem foreclosures initiated on or after July 1, 2011. In rem foreclosures are initiated by docketing the judgment. If your taxing unit has docketed in rem judgments since July 1, you should make sure that the judgments included the newly increased charge. If not, you should docket amended judgments that include the \$250 charge and remember that doing so will reset the clock on the two months you need to wait before requesting execution.

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