
Coates' Canons Blog: When a Local Government Purchases Property at a Tax Foreclosure (Part II)

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Tax fans, I know you've been eagerly anticipating the sequel to my last post, which ended in a thrilling cliff-hanger: What must we do with sale proceeds and outstanding taxes after a local government sells property it purchased at a tax foreclosure sale?

Your wait is over! Read on to learn the stunning conclusion . . .

Distribution of Sale Proceeds

Regardless of the sale method, when a local government sells property it purchased at a tax foreclosure it must share the proceeds of that sale with other local governments that had liens on the property. G.S. 105-376(b).

All taxes, interest and costs have the same payment priority regardless of which year they arose or which government levied the taxes. This total must include taxes that would have become a lien on the property on the most recent January 1 if the property had not been owned on that date by the local government. G.S. 105-376(a).

If the sale does not produce enough cash to pay off all of the taxes, interests and costs, these debts must be satisfied pro-rata based on the percentage of the total owed to each local government. Special assessments are paid after taxes, interest and costs; if no money remains after paying off the taxes, then special assessments will not be paid.

Assume Carolina County purchased Parcel A at its foreclosure sale in November 2014. At the time, \$10,000 in taxes, interest, costs, and special assessments were owed on the property. \$6,000 of that amount was owed to the county. \$4,000 of that amount was owed to Blue Devil City, including \$2,000 in special assessments.

Carolina County decides to sell Parcel A in 2015. The 2015 taxes would have become a lien on the property by the date of sale were it not owned by the county. G.S. 105-376(a) requires us to add those new taxes to the old property taxes that were included in the original foreclosure action when distributing the sale proceeds.

The 2015 taxes will be estimated if the city and the county have not set their tax rates by the date of sale. Let's assume that those estimated 2015 taxes total \$4,000; \$3,000 for the county, \$1,000 for the city.

As a result, the county holds the property for the benefit of itself and the city for a total of \$14,000 in taxes, special assessments, and related interest and costs.

Assume Carolina County sells the property at a public sale for only \$8,000, meaning some of the \$14,000 in local government obligations on the property will not be paid.

Here is how the sale proceeds should be distributed:

Property taxes, interest and costs: Including the post-foreclosure 2015 taxes, a total of \$12,000 in taxes, interest and related costs are owed on the property. Because the sale did not produce enough cash to pay off all of these amounts, the local governments will be paid pro-rata.

The county accounts for 75% of the total (\$9,000/\$12,000) while the city accounts for 25% (\$3,000/\$12,000). The county should receive 75% of the \$8,000 sale proceeds, or \$6,000. The city should receive the remaining \$2,000.

Special Assessments: Because special assessments are paid after property taxes, interest and costs, there are no funds left to pay these debts.

Surplus Proceeds: In this example, there are not enough funds to pay off all of the amounts owed on the property, much less any surplus proceeds. But what if the local government is able to sell the property for a price that exceeds all of the taxes, interest, costs, and other amounts owed on the property? In that happy scenario, the local government is entitled to keep the extra cash and use it for any legal public purpose. That's very different from when the original foreclosure sale produces surplus proceeds; in that case, the cash remaining after all taxes, costs, interests and other debts owed on the property are paid must be turned over to the clerk of court for distribution to other creditors or to the taxpayer who originally owned the property.

Status of Tax Liens on the Property

Regardless of the sale price, the property will be sold free and clear of liens for all amounts included in the tax foreclosure. G.S. 105-375(i). All of those liens were extinguished by the foreclosure sale.

The only lien that might remain on the property would be the tax lien for the coming fiscal year (2015, in this case). Because that lien was not included in the foreclosure judgment, it remains on the property if not paid in full with the sale proceeds. The local government conducting the sale must inform the buyer that if the sale proceeds are not sufficient to satisfy all taxes owed on the property the buyer will take the property subject to the tax lien for the coming fiscal year.

In the above example, the sale produced \$8,000, all of which would first be applied to the old county and city property taxes owed on the property. (See this post for more on allocating tax payments.) There would be no funds available to pay any of the estimated 2015 taxes on the property. The buyer would take Parcel A subject to a lien for the full 2015 county and city tax bills.

What to do with the unpaid taxes?

Because property is sold free and clear of all liens included in the foreclosure, the local government has no remaining remedies against the real property to satisfy those taxes. The government also loses all Machinery Act collection remedies against the responsible taxpayer's *personal* property once a foreclosure action begins. G.S. 105-366(b).

Remember we are now talking about only the taxes that were included in the original foreclosure action. The 2015 taxes, although included for purposes of distributing the post-foreclosure sale proceeds, were not part of the original foreclosure action. Taxes not included in the original foreclosure remain a lien on the property and remain fully collectible, as discussed above.

The only collection remedy for unpaid taxes included a foreclosure is the set-off debt collection process aimed at taxpayers' state income tax refunds or lottery winnings. G.S. Ch. 105A. However, the success of that remedy is far from guaranteed.

If the taxpayer never receives a state income tax refund from North Carolina or never is lucky enough to win the lottery, the local governments are out of luck. The same is true if the taxpayer is not an individual. Although the set-off debt collection statute authorizes its use against corporations, as of 2015 the clearinghouse that processes the requests had not developed procedures for use against any taxpayers other than individual taxpayers.

As a result, most local governments will want to "write off" unpaid taxes following a foreclosure. Technically, the only way to do this is through the insolvents list described in the Machinery Act's settlement provision. G.S. 105-373(a)(2) and (g).

If a foreclosure does not produce enough cash to satisfy the taxes included in that action, the tax collector may ask the governing board to place those taxes on the insolvents list. Once those taxes are at least five years past due, the tax collector may ask the governing board to relieve the tax collector of the obligation to collect those taxes. If the board does so, the taxes need not be included on any future settlements or similar reports by the tax collector to the board.



Links

- canons.sog.unc.edu/?p=8157
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-376
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-375
- canons.sog.unc.edu/?p=8077
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-366
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/ByChapter/Chapter_105A.html
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