UNC SCHOOL OF GOVERNMENT
THE UNIVERSITY of NORTH CAROLINA at CHAPEL HILL

PROPERTY TAX BULLETIN NO. 158 | OCTOBER 2010

Foreclosure Myths

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Foreclosure is the process of enforcing a lien on real property by selling the property to the highest bidder. The procedural requirements for tax foreclosures have been expertly detailed by former School of Government Professor William A. Campbell in his book *Property Tax Lien Foreclosure Forms and Procedures*.[1] Although the most recent edition of this book was published in 2003, the information therein remains accurate. Therefore this bulletin will not delve into the procedural issues Professor Campbell has already covered extensively but instead will attempt to eliminate some of the confusion surrounding tax foreclosures by debunking ten recurring myths about this process.

Only taxing units may pursue tax foreclosures.[2] In North Carolina the Machinery Act provides for two different tax foreclosure procedures. The first is the mortgage-style procedure created by Section 105-374 of the North Carolina General Statutes (hereinafter G.S.), which involves a standard civil action filed in state court. The second is the in rem procedure created by G.S. 105-375, an expedited procedure that permits a taxing unit to docket a judgment against the property in state court and proceed with a foreclosure sale three months later.

Neither procedure can begin until after taxes become delinquent. Nondeferred taxes on real property and taxes on personal property other than registered motor vehicles become delinquent when interest begins to accrue on January 6 of the year in which the taxes were levied.[3] Nearly all taxing units advertise their tax liens prior to initiating any foreclosures, but such advertisements are required only for in rem foreclosures.[4]

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1. This publication is available for purchase from the School of Government at http://shopping.netsuite.com/s.nl/c.433425/it.A/id.68/.f. Professor Campbell's recommended forms are also available in CD-ROM format for ease of use by practitioners and can be purchased at http://shopping.netsuite.com/s.nl/c.433425/it.A/id.185/.f.

2. Until the early 1980s, foreclosures could be inititated by private parties who had purchased tax liens from taxing units. In 1983 the General Assembly enacted legislation that ended the sale of property tax liens by taxing units. 1983 N.C. Sess. Laws ch. 808.

3. N.C. Gen. Stat. (hereinafter G.S.) § 105-365.1. Deferred taxes become delinquent on the date a disqualifying event occurs. If the disqualifying event is the death of the owner, the deferred tax becomes delinquent on the first day of the ninth month after the death.

4. G.S. 105-375(b) prohibits a tax collector from docketing a judgment against real property for delinquent property taxes until thirty days after the tax lien advertisement runs. For details regarding the advertisement process, see Christopher B. McLaughlin, "Advertising Tax Liens," *Property Tax Bulletin* No. 148 (July 2009), available at www.sog.unc.edu/pubs/electronicversions/pdfs/ptb148.pdf.

The tax lien that is the basis for a foreclosure should include taxes on the real property itself and taxes on all personal property other than registered motor vehicles owned by the same taxpayer in the same jurisdiction.[5] The lien may also include special assessments and other obligations—such as nuisance abatement costs—that are collectible as property taxes.[6] The tax lien on real property should not include taxes on other real property owned by the taxpayer.[7]

If the taxpayer does not satisfy the outstanding taxes and the foreclosure continues to a sale, the sale proceeds are applied first to the costs of the foreclosure and then to the taxes, special assessments, and other obligations included in the tax lien. Any surplus funds should be turned over to the court for distribution to junior lienholders or to the taxpayer who owned the property prior to foreclosure.[8]

Ten foreclosure myths that deserve debunking follow.

Myth 1: The in rem foreclosure process may violate the U.S. or N.C. constitutions.

The expedited nature of in rem foreclosures has been the source of numerous court challenges to the process in its sixty-plus-year history. Owners and lienholders have repeatedly alleged that the in rem procedure fails to provide constitutionally adequate notice to interested parties before property is sold and their interests terminated.[9] Although none of these legal challenges have managed to invalidate G.S. 105-375, several identified weaknesses in the in rem procedure subsequently remedied by the General Assembly. For example, the statute originally required that notice be provided only to the taxpayer that originally listed the property for taxation even if that taxpayer no longer owned the property. The statute now requires notice be given to the current owner of the property, a more logical and constitutionally sound approach.

Court rulings in other jurisdictions motivated the General Assembly to enact additional amendments to the statute. Most notable was *Mennonite Board of Missions v. Adams*,[10] a 1983 U.S. Supreme Court decision that struck down part of a similar Indiana tax foreclosure statute because it did not require that notice be mailed to lienholders. The Court held that lienholders, like property owners, "are entitled to notice reasonably calculated to apprise [them] of a pending tax sale."[11] After *Mennonite*, lienholders such as mortgagees are entitled to notice of the foreclo-

5. G.S. 105-355(a). G.S. 105-330.4(c) excludes taxes on registered motor vehicles from the real property tax lien.

6. For a full discussion of property tax liens, see Christopher B. McLaughlin, "The Property Tax Lien," *Property Tax Bulletin* No. 150, available at www.sog.unc.edu/pubs/electronicversions/pdfs/ptb150.pdf.

7. G.S. 105-355(a).

8. See McLaughlin, *supra* note 6.

9. *See, e.g.,* Hardy v. Moore County, 133 N.C. App. 321 (1999) (county not required to locate taxpayer's new address by contacting the country club of which the property was a part; acceptable for county to mail notice to taxpayer's last known address in England); Jenkins v. Richmond County, 99 N.C. App. 717 (1990) (due process not satisfied when city did not attempt to mail notice to each individual taxpayer listed on the most recent deed to the property being foreclosed upon); Overstreet v. City of Raleigh, 75 N.C. App. 351 (1985) (both mortgage-style and in rem foreclosures defeat claims of adverse possession without the foreclosing government having to give individual notice to persons who might hold adverse possession claims).

10. 462 U.S. 791 (1983).

11. 462 U.S. at 798.

sure by mail rather than simply by publication if their addresses can be obtained without undue hardship.

The *Mennonite* decision was the basis for a 2010 challenge to an in rem foreclosure sale conducted by the city of Charlotte for unpaid demolition costs. In *Da Dai Mai v. Carolina Holdings, Inc.*,[12] the plaintiff, Carolina Holdings, held a lien on the property that was sold by the city of Charlotte. As required by G.S. 105-375, the city sent letters to the property owner and to Carolina Holdings prior to docketing a judgment against the property. Months later the city mailed notice of sale to the property owner but not to Carolina Holdings, in accord with the statute's requirements. The city also published notice of the sale in a local newspaper, but Carolina Holdings claimed it didn't learn of the sale to Mai until a full year later. Carolina Holdings then challenged the in rem procedure in court, alleging that failure to provide personal notice to lienholders of record violates the due process clauses of the Unites States and North Carolina constitutions.

Carolina Holding's argument fell on deaf ears. The N.C. Court of Appeals found that the *Mennonite* standard was more than satisfied by the G.S. 105-375 requirement that lienholders receive notice via registered or certified mail of the intent to docket a judgment months before a foreclosure sale. The court based its decision in large part on language from *Henderson County v. Osteen,* a N.C. Supreme Court case that spoke approvingly of the in rem procedure.[13] Building on *Osteen,* the N.C. Court of Appeals concluded that failure to send a second notice to lienholders such as Carolina Holdings prior to the actual foreclosure sale does not render the entire process constitutionally inadequate. Essentially the court found that Carolina Holdings ignored the initial notice of the foreclosure at its peril and could not legitimately complain that it was harmed by its failure to learn of the specific sale date.

The importance of the *Mai* decision lies not only in its substantive holding—it is acceptable to mail only a single notice to lienholders—but also in its unqualified adoption of the N.C. Supreme Court's language in *Osteen,* language previously considered nonbinding *dicta* and now more appropriately viewed as a conclusive blessing of the in rem foreclosure procedure.

The *Mai* decision should reassure local governments that rely on the in rem procedure for tax foreclosures. Courts surely will continue to scrutinize in rem foreclosures to ensure that local governments follow the procedural requirements with extreme particularity. And a taxing unit will always be wise to exceed the minimum notice requirements when it can do so without great effort—for example, by sending a second notice to lienholders if addresses are easily obtainable. But in general the *Mai* case demonstrates that the in rem procedure stands on solid constitutional ground.

12. ___ N.C. App. ___, 696 S.E.2d 769 (2010).

13. 292 N.C. 692 (1977). In this case, the court held that the Machinery Act's immaterial irregularity provisions do not permit a taxing unit to proceed with an in rem foreclosure sale without first attempting to provide the owner with individual notice. While reaching that decision, the court observed that if the taxing unit had provided such individualized notice, the in rem procedure "would, in our opinion, be sufficient to satisfy the fundamental concept of due process and, therefore, to comply with Article 1, section 19, of the Constitution of North Carolina and the Due Process Clause of the Fourteenth Amendment of the Constitution of the United States." *Id.* at 708.

Myth 2: Foreclosure may be used to collect only property taxes.

Foreclosure is available to collect any obligation owed to a local government that constitutes a lien on real property. As discussed above, all property taxes other than those owed on registered motor vehicles are liens on real property as of January 1 of the year in which they are levied. Other local taxes—such as occupancy, privilege license, and food and beverage levies—do not constitute liens on real property unless the local government sues the taxpayer for nonpayment and obtains a judgment. The same applies to most nontax obligations, such as license and inspection fees and utility and user fees.

However, four types of obligations do create liens on real property without additional government action. Special assessments, public nuisance abatement costs, minimum housing standards enforcement costs, and solid waste fees billed with property taxes all automatically create liens on a taxpayer's real property.[14] Any one of these obligations can be the basis for foreclosure actions even if the taxpayer owes no property taxes.

If property taxes are also involved in a foreclosure related to nonpayment of one of these obligations, questions of priority (that is, who gets paid first) will arise. Liens for public nuisance abatement costs and solid waste fees billed with property taxes share the same priority as property tax liens and are paid at the same time as property taxes after the foreclosure sale.[15] The liens for special assessments and minimum housing standards enforcement costs are junior to tax liens but senior to private liens such as those held by mortgage lenders.[16]

Myth 3: Real property owned by the sole shareholder of a corporation or sole member of a limited liability corporation can be foreclosed upon to satisfy the corporation's tax obligations.

Corporations and their shareholders are distinct and separate taxpayers that must list their respective property separately for taxation.[17] Because the tax obligations of one taxpayer cannot be the basis for enforced collection actions against the property of another taxpayer, generally shareholders and members cannot be held liable for the tax obligations of their corporations.[18] For example, assume Wanda Wolfpack is the sole shareholder of Wolfpack Inc., which owes delinquent property taxes on its business personal property. Wanda owns Parcel A, on which the taxes are current. The tax collector may not foreclose on Parcel A to satisfy the taxes owed by Wolfpack Inc., because Wanda and the corporation are separate taxpayers—even though she

14. G.S. 153A-200(c) and G.S. 160A-233(c) (special assessments); G.S. 153A-140 and G.S. 160A-193 (nuisance abatement costs); G.S. 160A-443(6)(a) (minimum housing standards enforcement costs); G.S. 153A-293 and G.S. 160A-314.1 (solid waste fees billed with property taxes). For solid waste fees, the governing board must first adopt an ordinance mandating that the fees be billed and collected in the same manner as property taxes. For more details about the collection of other taxes and fees, see Christopher B. McLaughlin, "Beyond the Property Tax: Collecting Other Taxes and Fees," *Property Tax Bulletin* No. 154 (April 2010), available at www.sog.unc.edu/pubs/electronicversions/pdfs/ptb154.pdf. For more details about the priority of local government liens on real property, see McLaughlin, *supra* note 6.

15. See McLaughlin, *supra* note 6.

16. *Id*.

17. G.S. 105-302(c)(2) (real property) and G.S. 105-306(c)(3). The same is true of limited liability corporations and their members.

18. *See* G.S. 55-6-22 (providing that shareholders are not liable for the acts of the corporation).

owns and controls the corporation. The same would be true if Wanda owed taxes on her personal property and Wolfpack Inc. owned Parcel B. Wolfpack Inc.'s real property could not be subject to foreclosure to satisfy taxes owed by its sole shareholder.

These same principles apply to any situation in which there exist multiple related but distinct taxpayers, including partners and partnerships,[19] trusts and trustees,[20] and spouses.[21] Tax obligations of one of those taxpayers may not be the basis for foreclosure on real property owned by the related taxpayer.

There are two situations in which shareholders can be held liable for the obligations of their corporations, but they rarely arise. The first is when a corporation has formally dissolved without giving proper notice to its creditors. Those creditors may then hold the shareholders liable for the dissolved corporation's debts to the extent that the shareholders received corporate assets when the corporation was dissolved.[22] Unfortunately, when small corporations go out of business often they do not formally dissolve—they simply stop functioning as corporations and thus the dissolution remedies are no help to creditors.

The second situation in which shareholders can be held liable for a corporation's tax obligations is when one or two shareholders have abused the corporate form and used the corporation as an alter ego to avoid personal liability for certain obligations. In such cases a court may permit creditors to "pierce the corporate veil" and hold the shareholder(s) personally liable.[23] Such a remedy is granted only in cases of egregious behavior by shareholders, and it is unclear whether the simple failure to pay corporate property taxes would meet this standard.[24]

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19. G.S. 105-366(b)(8) permits a tax collector to proceed against a partner's personal property for a partnership's tax obligation if the tax collector cannot satisfy the partnership's property taxes. But a partner's real property is always immune from collection for a partnership's tax obligation.

20. Property owned by a trust is listed in the name of the trustee in his or her fiduciary capacity only and does not subject the trustee's individual property to enforced collection actions for the trust's tax obligations. G.S. 105-302(c)(7) and G.S. 105-306(c)(6).

21. Real property owned by spouses as tenants by the entirety is considered to be owned by a separate taxpayer—the marital unit—from the individual spouses. Taxes owed by an individual spouse cannot be the basis for a foreclosure action against real property owned by the spouses as tenants by the entirety. *See* G.S. 105-302(c)(10) and Davis v. Bass, 188 N.C. 200 (1924). Similarly, taxes on property owned by one spouse individually may not be the basis for a foreclosure action on property owned by the other spouse individually.

22. G.S. 55-14-08 and G.S. 57C-6-09.

23. *See* State v. Ridgeway Brands Mfg., LLC, 362 N.C. 431 (2008) (permitting state to pierce the corporate veil because of controlling shareholders' efforts to avoid required payments to state tobacco litigation settlement escrow fund).

24. The North Carolina Supreme Court requires the following to justify piercing the corporate veil: the shareholder must exert "complete domination, not only of finances, but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and such control must have been used by the defendant to commit fraud or wrong, *to perpetrate the violation of a statutory or other positive legal duty*, or a dishonest and unjust act in contravention of plaintiff's legal rights." B-W Acceptance Corp. v. Spencer, 268 N.C. 1, 9 (1966) (emphasis added). While the failure to pay property taxes by itself seemingly constitutes a "violation of a statutory duty," North Carolina courts have not addressed that specific scenario.

Myth 4: Foreclosure cannot be used against property owners who are exempt from property taxes or against taxpayers who have been through bankruptcy.

The only situation in which foreclosure is not available to enforce a valid tax lien on real property is when the property is currently owned by the state, a local, or the federal government.[25] Otherwise, foreclosure remains an option even if the property is owned by a religious or charitable organization, an independent school, or another private party that is exempt from property taxes.

For example, assume that in February 2011 Tom Tarheel sells Parcel A to the Church of the Benevolent Blue Devil, a religious organization that will use the property for religious purposes and will therefore be exempt from property taxes. Because Parcel A was owned by a taxable owner as of January 1, 2011, it should be listed and assessed taxes for the 2011–12 tax year even though it is now owned by an exempt organization. If the 2011 taxes are not satisfied at closing and become delinquent as of January 6, 2012, the tax collector could enforce the lien against the church through attachment and garnishment, levy and sale, or foreclosure. While there may be political or public relations concerns associated with the use of enforced collection remedies against religious organizations or other exempt entities, the tax collector is obligated to use all methods at his or her disposal to collect taxes for which these parties are responsible.

Foreclosure can also be used against taxpayers dismissed or discharged from bankruptcy proceedings. The automatic stay prohibits foreclosures, attachments, and all other collection actions while a bankruptcy is pending, of course. But after the proceeding ends, tax collectors can resume collection of unpaid property taxes. In some circumstances the taxpayer may no longer be personally responsible for property taxes after discharge, meaning the taxpayer's personal property may not be attached or levied upon. However, the taxpayer's real property is still subject to foreclosure if the tax lien survives bankruptcy. Thankfully, most do.[26]

Myth 5: The Machinery Act's statute of limitations requires that the foreclosure sale must be completed within ten years of the original due dates for all delinquent taxes included in the foreclosure action.

The statute of limitations in G.S. 105-378(a) requires only that an enforced collection remedy be instituted within ten years of the tax's original due date. A foreclosure action is instituted either by the filing of a complaint under G.S. 105-374 or by the docketing of a judgment under G.S. 105-375. So long as one of those actions occurs prior to the ten-year cutoff, the statute of limitations will not serve as a defense to a foreclosure action even if the actual sale of the property does not occur until months later.

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25. *See* Vaughn v. Bd. of Commissioners of Forsyth County, 118 N.C. 636 (1896) (government property exempt from seizure and sale by creditors). *When a government purchases real property, it must satisfy all outstanding property tax liens* at closing. G.S. 105-385(d). If the government fails to do so, the taxing unit's only option is to sue the offending government in state court. This requirement does not apply if the government obtains the property through a gift or a bequest or any method other than a purchase.

26. For more details on property taxes and bankruptcy, see Shea Riggsbee Denning and Robert E. Price Jr., "Collecting Property Taxes in Bankrupty," *Property Tax Bulletin* No. 139 (August 2006), available at www.sog.unc.edu/pubs/electronicversions/pdfs/ptb139.pdf.

Taxes on real property and personal property other than registered motor vehicles are due on September 1 of the fiscal year for which they are levied.[27] As a result, a foreclosure action for a tax levied in year 0 must begin on or before August 31 in year 10 to avoid the statute of limitations concerns.

However, a statute of limitations is an affirmative defense that must be raised by a defendant to be effective.[28] The statute does not serve as a prior restraint on local governments' collection actions. If a defendant does not assert the statute of limitations as a defense, a taxing unit may proceed with a foreclosure action regardless of when the taxes originally came due.[29]

The "use-it-or-lose-it" nature of a statute of limitations defense raises interesting questions for tax collectors and local governments. Is it appropriate to initiate a collection action that can succeed only if the taxpayer is ignorant of his or her defenses under the Machinery Act? Would doing so be considered the equivalent of preying upon uninformed taxpayers or an admirable effort by the local government to collect all validly levied taxes?

Similar questions arise for attorneys who assist local governments with foreclosure actions. Attorneys are forbidden from proceeding with frivolous actions that lack legal merit.[30] But attorneys do not violate this ethical rule by proceeding with an action that could be barred by the statute of limitations because that time limitation does not affect the substantive validity of the underlying claim.[31]

However, the same ethical conclusions probably should not apply to local governments. Local governments almost certainly have greater obligations to protect the interests of their taxpayers than attorneys have to protect the interests of opposing parties. For both ethical and political reasons, local governments are wise to avoid initiating foreclosures or other collection actions based entirely on taxes more than ten years past due.

Including taxes outside the ten-year limitation in a collection action that also involves taxes less than ten years past due should be less problematic. For example, assume a local government is owed taxes from the years 2000 through 2010 on Parcel A. If that local government proceeds with a foreclosure action on Parcel A in 2011, the 2000 taxes would fall outside of the ten-year limitation because they were originally due on September 1, 2000. Regardless, the 2000 taxes should probably be included in the foreclosure action because even if the taxpayer raises the statute of limitations defense, the foreclosure could proceed. Accusations of unfairness or deceptive collection practices would less likely gain traction in that situation as compared to a foreclosure action that included only time-barred taxes.

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27. G.S. 105-360(a). Taxes on registered motor vehicles are due on the first day of the fourth month following the date a prior registration expires or a new registration is applied for. G.S. 105-330.4. But because taxes on registered motor vehicles are never a lien on real property, the due date for these taxes is irrelevant to foreclosure actions. G.S. 105-330.4(c).

28. G.S. 1A-1, Rule 8(c), of the N.C. Rules of Civil Procedure.

29. Iredell County v. Crawford, 262 N.C. 720 (1964).

30. N.C. Rules of Professional Conduct, Rule 3.1.

31. 2003 N.C. Formal Ethics Opinion 13 ("Filing suit after the limitations period has expired does not affect the validity of the claim, nor does it divest a court from having jurisdiction to hear the matters raised therein. . . . Because a time-barred claim can be enforced by a court if the defense raises no objection, filing suit under these circumstances would not violate the prohibition against an attorney advancing a frivolous claim under Rule 3.1"). This opinion mirrors those reached by other ethics committees across the country. *See, e.g.,* American Bar Association Formal Opinion 94-387.

Myth 6: At a tax foreclosure sale, the minimum bid must be set at the total amount of taxes, interest, fees, and costs owed on the property.

The Machinery Act does not require a minimum bid at a foreclosure sale. Under both mortgage-style and in rem foreclosures, property must be sold to the highest bidder.[32] If the government conducting the foreclosure sale chooses not to enter an opening bid, then any bid from any party—including the taxpayer who owns the property being sold—will be sufficient to purchase the property, even if that bid does not cover the outstanding taxes.[33] In addition, the purchaser will take the property free and clear of all tax liens included in the foreclosure action.[34]

To ensure the property is not sold for less than the amount the government is owed, it must enter its own bid in that amount. This opening bid should include all amounts owed by the taxpayer, including the taxes and special assessments of all local governments party to the action plus interest and the costs of the foreclosure. If no one else bids on the property, the government will become the owner of the property after the upset bid period ends.

Unlike all other winning bidders, when a local government finalizes its purchase of real property at a tax foreclosure sale, it need not pay the entire bid in cash. The purchasing government may elect to pay "only that part of the purchase price that would not be distributed to it and other taxing units on account of taxes, penalties, interest and such costs as accrued prior to the initiation of the foreclosure action."[35] In other words, the purchasing government must pay only the foreclosure costs owed to third parties, usually the attorney who represented the government in the foreclosure and, for in rem foreclosures, the sheriff who conducted the sale. The purchasing government is not required to pay itself or other local governments for the taxes and other amounts owed on the property. However, if the purchasing government later sells the property, it must use the proceeds to satisfy the tax liens held by itself and other governments after first repaying itself for the out-of-pocket foreclosure expenses.[36] Myth 9 provides more details about a local government's obligations after purchasing property at a foreclosure sale.

Myth 7: If multiple local governments hold property tax liens on the property sold at foreclosure, the oldest taxes have priority and are paid first.

All local government property tax liens are of equal dignity.[37] This means that they all have the same payment priority, regardless of when they arose or which government initiated the foreclosure action. If the sale proceeds are insufficient to satisfy all of the tax liens, then after costs

32. G.S. 105-374(m) for mortgage-style foreclosures and G.S. 1-339.51 for in rem foreclosures.

33. Although the Machinery Act does not limit the types of eligible bidders at foreclosure sales, other conflict of interest laws and regulations might. For example, G.S. 14-234.1 prohibits a government official from obtaining property about which he or she possesses "information which was made known to him in his official capacity and which has not been made public." This statute effectively prohibits bids from county employees who have nonpublic insider information about property being sold at foreclosure. Conflict of interest considerations also prohibit an attorney who is prosecuting the foreclosure on behalf of the local government from bidding at the sale, even if that attorney does not have the insider information covered by G.S. 14-234.1. *See* 2006 N.C. Formal Ethics Opinion 5, available at www.ncbar.com/ethics/.

34. G.S. 105-374(k) and G.S. 105-375(i).

35. G.S. 105-376(b).

36. *Id*.

37. G.S. 105-356(a)(2). Also paid at the same time as local government property tax liens are liens for solid waste fees authorized to be billed as property taxes and liens for public nuisance abatement costs.

are satisfied the tax liens are paid proportionately.[38] For example, assume that Carolina County has a $1,000 property tax lien from 2005 on Parcel A. Blue Devil City has a $500 lien on the same parcel for 2007 property taxes. The fact that Carolina County's tax lien is older than Blue Devil City's tax lien is irrelevant to the priority of those liens; they both are of equal dignity and are paid at the same time. Nor does it matter which government initiates the foreclosure action. If either Carolina County or Blue Devil City forecloses on Parcel A and the sale produces $600 after costs are paid, then the two jurisdictions would split the proceeds proportionately: $400 (two-thirds) for Carolina County and $200 (one-third) for Blue Devil City.[39]

Myth 8: If the foreclosure sale does not produce enough funds to satisfy the taxes owed, the local government may use enforced collection remedies against the taxpayer's personal property to make up the difference.

Foreclosure is the ultimate Machinery Act collection remedy. Tax collectors may not target a taxpayer's personal property through attachment and garnishment or levy and sale after a foreclosure action is initiated.[40] If the foreclosure sale does not produce enough funds to satisfy all costs and taxes owed, the tax collector no longer has any Machinery Act collection options against the former owner for the deficiency.

Property sold at foreclosure is deeded to the purchaser free and clear of all liens included in the judgment, meaning that the new owner cannot be held responsible for the prior owner's unpaid taxes.[41] The only tax lien that can remain on real property after a foreclosure is the lien for taxes that cannot be determined at the time of the judgment because the tax rate has not yet been set. For example, assume that in late 2010 Carolina County initiates a foreclosure action against Parcel A for unpaid taxes from 2008 and 2009. The property goes to sale in January 2011. The attorney or tax official prosecuting the foreclosure should include the 2010 taxes in the judgment and sale even though those taxes were not delinquent when the action was initiated.[42] The 2011 taxes should not be included because the final amount of those taxes cannot be determined until the county sets its property tax rate for 2011–12. As a result the 2011 tax lien is

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For solid waste fees, see G.S. 153A-293 (counties) or G.S. 160A-314.1 (municipalities). For nuisance abatement costs, see G.S. 153A-140 (counties) or G.S. 160A-193 (municipalities). As is true for property tax liens, the priority of solid waste liens and nuisance abatement liens is not affected by the identity of the foreclosing party.

38. This rule also applies to the proceeds from the sale of real property purchased by a local government at a tax foreclosure sale. *See* G.S. 105-376(b) and Myth 9.

39. For more details on the priority of tax liens, see McLaughlin, *supra* note 6.

40. G.S. 105-366(b). This prohibition is triggered by the filing of a foreclosure complaint under G.S. 105-374 or the docketing of a judgment under G.S. 105-375, regardless of whether the foreclosure proceedings are completed.

41. G.S. 105-374(k) and G.S. 105-375(i).

42. The complaint in a mortgage-style foreclosure should include an allegation of "subsequent taxes which are or may become a lien on the same real property." G.S. 105-374(e). Immediately before the sale is ordered by the court, the taxing unit should file a certificate listing all of the taxes, interest, and costs it is owed, including those not yet delinquent. The only exception is a tax lien for which the exact amount of tax owed cannot be determined at the time of judgment. When proceeding with an in rem foreclosure, the certificate of taxes owed should include all taxes that are liens on the property and that can be determined at the time of foreclosure, even if those taxes are not yet delinquent. G.S. 105-375(b).

the only lien that will survive the foreclosure sale, even if the sale price is not enough to satisfy the 2008, 2009, and 2010 taxes.[43]

Once foreclosure occurs, the tax collector is out of options under the Machinery Act. The only collection remedy that remains after foreclosure is the set-off debt collection procedure under Chapter 105A, which permits a local government to attach a taxpayer's state income tax refund or lottery winnings. But this option is of course only helpful if the taxpayer is entitled to a refund or wins the lottery.

For all of these reasons, plus the fact that foreclosures take several months at a minimum to complete, most tax collectors will first exhaust remedies against a taxpayer's personal property before turning to foreclosure. That said, the Machinery Act does not require a tax collector to exhaust these remedies first. A tax collector may choose among Machinery Act remedies unless (1) the governing board orders the tax collector to first target a taxpayer's personal property or (2) a taxpayer or lienholder requests that the collector first turn to the taxpayer's personal property and gives the tax collector a description and location of that property.[44]

Myth 9: If the county or city purchases real property at a tax foreclosure sale, it cannot subsequently sell the property for less than the total amount of taxes, interest, and costs owed on the property.

Local governments often end up owning foreclosed property because no bidders are willing to top the governments' opening bids set at the amount of taxes, interest, and costs owed on the foreclosed properties. As discussed above, local governments are not required to submit opening bids, but most do so to prevent bidders from purchasing the foreclosed property for less than the amounts owed. Once a local government becomes the owner of foreclosed property, it may use or dispose of that property just as it may with any other property it owns.

If the purchasing government wishes to use the property for a public purpose, it may do so. This option will remove the property from the tax rolls and effectively eliminate any possibility of recovering the delinquent taxes on the property owed to that government and other local governments. As a result, the Machinery Act requires a purchasing government wishing to make public use of purchased property to compensate other local governments that are owed taxes on the property. The interested governing bodies (that is, the county commissioners and the city council) should agree on the amount of compensation. If the parties cannot agree, then the superior court is authorized to set the amount.[45] That said, a local government can perhaps best protect its interest in foreclosed property by itself bidding on the property, thus preventing another government from purchasing it and controlling its disposition.

If the local government instead wishes to dispose of the property and get it back on the property tax roll, it may do so pursuant to the property disposal rules in Article 12 of G.S. Chapter 160A, subject to two important restrictions created by the Machinery Act.[46] First, the government that purchased the property at foreclosure holds it for the benefit of all other taxing

43. The 2011 taxes would already be a tax lien on the property as of the time of judgment, because the tax lien on real property arises as a matter of law on the listing date, January 1, regardless of when the actual tax obligation is determined. G.S. 105-355(a).

44. G.S. 105-366(a).

45. G.S. 105-376(b).

46. Although on its face G.S. Chapter 160A, Article 12, applies only to municipalities, G.S. 153A-176 makes these provisions applicable to counties as well.

jurisdictions that were parties to the foreclosure sale.[47] This provision means that if the purchasing government eventually sells the property, it must use the sale proceeds to satisfy all tax liens included in the foreclosure sale, after paying itself back for any costs it previously paid. Second, if the purchasing government sells the property to the taxpayer who owned the property prior to foreclosure, the sales price cannot be lower than the total taxes, interest, penalties, and costs originally owed by that taxpayer.[48]

For example, assume Wanda Wolfpack owes $5,000 in property taxes to Carolina County on Parcel A. The county proceeds with a foreclosure, and at the time of sale the amount of taxes, interest, and costs totals $6,000. If the county chooses not to enter an opening bid, then any party, including Wanda, could purchase Parcel A for $1. Assume that the county submits an opening bid of $6,000 and no other bids are received. After the upset bid period ends, the county would take ownership of Parcel A. If it later attempts to sell the property, the county could sell it to any party so long as the property disposition rules are followed. But if Wanda is the purchaser, the price cannot be lower than the $6,000 in taxes, interest, and costs she owed on the property at the time of foreclosure.

Regardless of who buys the property or for how much, it will be transferred from the local government to that buyer free and clear of all tax liens with the exception of those for taxes that could not be determined at the time of sale. Foreclosure extinguishes the tax liens and all junior liens on the property, even if the local government is the high bidder at the auction.[49]

Myth 10: A taxpayer can redeem his or her property within one year from the date of the foreclosure sale.

Several states provide for a post-sale redemption period in which a taxpayer may pay the taxes and costs owed on the property and reverse a foreclosure sale.[50] But in North Carolina, the taxpayer has no right of redemption after a foreclosure sale. After a mortgage-style foreclosure is confirmed by the court or the upset bid period ends for an in rem foreclosure sale, a North Carolina taxpayer cannot reverse the sale simply by paying the amounts owed on the property. The taxpayer's only option after the sale of property at a tax foreclosure has been confirmed is to initiate a legal action challenging the validity of the process. The Machinery Act requires that any such legal challenge be raised within one year of the date on which the foreclosure deed is recorded.[51]

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47. G.S. 105-376(b).

48. G.S. 105-376(c). As noted above, this restriction does not apply to the initial foreclosure auction sale and the subsequent upset bid period.

49. G.S. 105-374(k) and G.S. 105-375(i) require property to be sold at foreclosure free and clear of all tax liens except for taxes not yet determined because the taxing unit has not set its tax rate. *See also* Dixieland Realty Co. v. Wysor, 272 N.C. 172 (1967) (foreclosure of senior mortgage extinguishes junior mortgages and liens) and G.S. 1-339.68 (real property sold at execution subject only to senior liens).

50. For example, Texas allows a taxpayer two years to reverse a tax foreclosure sale by paying the purchaser the sale amount, the outstanding taxes and costs, and a redemption premium of 25 to 50 percent of the purchase price. Tex. Tax Code § 34.21, available at www.statutes.legis.state.tx.us/Docs/TX/htm/TX.34.htm#34.21.

51. G.S. 105-377. That said, courts may be willing to ignore this limitation when a plaintiff complains of a constitutionally defective lack of notice. *See* Henderson County v. Osteen, 292 N.C. 692 (1977)

At any point before a court confirms a mortgage-style foreclosure sale or before the upset bid period ends for an in rem foreclosure, the taxpayer or any other party can redeem the property and stop the foreclosure procedure by paying all of the taxes, costs, and fees owed on the property.[52] For example, assume Billy Blue Devil owns a property being foreclosed upon by Carolina County using the mortgage-style procedure for $10,000 in taxes and costs. The high bid at the initial auction of Billy's property is $50,000. Billy may redeem his property prior to confirmation of sale for $10,000, even though the high bid is $40,000 more than the amount owed on the property. Although this option seems unfair to the foreclosing entity, in reality the county would not lose any money if Billy were to redeem his property after the $50,000 bid was received. All sale proceeds in excess of the $10,000 in taxes and costs owed to the county would be turned over to the court for distribution to junior lienholders or to Billy.

(holding that the one-year limitation did not apply to motion by deceased taxpayer's heirs and administrator to set aside in rem foreclosure sale for lack of notice).

52. G.S. 105-374(e) (mortgage-style foreclosure can be stopped at any point up to confirmation); G.S. 105-375(g) and G.S. 1-339.57 (in rem foreclosure can be stopped at any point prior to the expiration of the upset bid period). For both mortgage-style and in rem foreclosure sales, other bidders can upset the high bid at the initial auction sale by submitting within ten days a bid that exceeds the original high bid by at least 5 percent, with a minimum increase of $750. G.S. 105-374(o) and G.S. 1-339.64. Every upset bid starts a new ten-day upset bid period, meaning foreclosure sales can continue for weeks or months if bidders keep upsetting each others' bids. The sale cannot be confirmed until the ten-day upset bid period ends without a new upset bid being submitted.

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