

What Every Lawyer Should Know About Delinquent Tax Suits

Judge Michael Landrum, 113th District Court

Should you find yourself defending a client who has been served with a suit for collection of delinquent *ad valorem* taxes, you should be aware of the statutes, rules and practices unique to delinquent tax cases.

This paper does not discuss the more involved topic concerning the valuation of taxable property, exemptions, or the actual levy of taxes. For the most part, such issues are first addressed in administrative proceedings before the county appraisal district and its appraisal review board. Beware, however: failure to pursue valuation related complaints through the administrative process generally precludes review in court. See generally TEXAS TAX CODE, Chapter 42.

This paper also does not discuss property tax exemptions that may be available in certain circumstances. See generally TEXAS TAX CODE, Chapter 11.

Citation

Rule 117a of the TEXAS RULES OF CIVIL PROCEDURE relates to citations in delinquent tax suits. It states, among other things, that a copy of a petition does not need to be served with the citation. But the citation does need to contain:

- A brief description of the property against which the tax is allegedly owed;
- The amount of taxes alleged to be owed to the plaintiff taxing unit, not including penalties, interest, and costs;
- A statement that the plaintiff seeks collection of the delinquent taxes and all penalties, interest and costs accrued until the date of final judgment; and
- The identity of all other taxing units that levy taxes on the subject property and that may also be entitled to bring a claim for delinquent taxes.

The citation must also contain notice that any taxes that may become delinquent after the suit is filed and before the entry of judgment will also be part of the lawsuit. And, in addition to other remedies, the suit seeks a judgment to foreclose the tax lien.

Ad Valorem Tax Basics

Section 11.01 of the TAX CODE provides that *ad valorem* taxes are levied against residential and commercial real property and against “business personal” property. The tax is based on the appraised value established by the county appraisal district. The appraisal district certifies its tax roll, which describes all property in the county and states the value determined for each property account. Each individual taxing jurisdiction then calculates its tax amount by applying its adopted tax rate to the appraised value, and issues a tax bill.

Lien. Section 32.01 of the TAX CODE provides that a lien securing the taxes automatically attaches to all taxable property on January first of each year. This occurs without the need for any instrument to be recorded.

Tax liens are superior to all other claims except for (1) claims against the estate of a decedent for last illness, funeral, and burial expenses and survivor’s allowance; (2) recorded restrictive covenants; and (3) recorded easements. TAX CODE §32.05.

The tax lien is not extinguished in a bankruptcy.

Due Date. Ad valorem taxes are due when invoiced. TAX CODE §31.02(a). Tax statements are to be mailed “by October 1, or as soon thereafter as practicable”. TAX CODE §31.01(a).

Delinquency Date. If the taxes are not paid before February 1 of the following year for which the tax is imposed, the taxes become delinquent, meaning that a suit to collect the taxes and foreclosure of the tax lien may be brought. TAX CODE §31.02. For example, the taxes for year 2016 are due when the bill is issued, but must be paid not later than January 31, 2017 to avoid late payment penalties and interest. Mailing the payment on January 31st is sufficient to avoid delinquency as long as it is postmarked by January 31. TAX CODE §1.08.

If, however, a tax statement is issued after January 10th of the year after the applicable tax year, then the delinquency date for the taxes is “postponed to the first day of the next month that will provide a period of at least 21 days after the date of mailing for payment of taxes...” TAX CODE §31.04(a). If the owner is on active military duty during war or a national emergency, the delinquency date is postponed until after the owner returns from active duty. TAX CODE §31.02 (b).

It is very expensive to pay *ad valorem* taxes late.

Penalties and Interest. Substantial penalties are imposed if *ad valorem* taxes are paid after the delinquency date. TAX CODE §33.01(a). A penalty of 6% of the amount of the principal amount of taxes due (not 6% per annum) is imposed immediately on February 1st, and an additional penalty of 1% of the “base tax” amount is imposed on the first day of each of the following months until the taxes are paid. If the taxes are not paid by July 1, the total penalty becomes 12% of the base tax amount. The penalties are capped at that amount.

Additionally, unpaid taxes accrue interest at the rate of 1% per month beginning on the delinquency date. TAX CODE §33.01(c). So, with penalties and interest, the taxing entities will sue for the “base tax” plus 7% if paid in February; 9% if paid in March; 11% if paid in April; 13% if paid in May; 15% if paid in June; 18% if paid in July; and an additional 1% interest each month thereafter.

Attorney Fees. In addition to penalties and interest, the Tax Code §33.48 provides that the plaintiff shall recover attorney fees if suit is filed and the delinquent taxes are not paid before July 1. The taxing jurisdiction and its counsel may set the attorney fee, but the fee cannot exceed 20% of the total of the delinquent tax, penalties, and interest. TAX CODE §6.30(c). As a practical matter, attorney fees will always add 20% to the bill for unpaid taxes.

Like the penalties and interest, attorney fees are mandatory, and the court does not have discretion to award a different amount. *Aldine Independent School District v. Ogg*, 122 S.W.3d 257 (Tex. App. – Houston [1st Dist.], 2003, no pet.)¹

Costs. The taxing entities are also entitled to recover court costs, the cost for filing a notice of *lis pendens*, expenses of a tax foreclosure sale, expenses for identifying the property, expenses for determining the identity and location of necessary parties, and reasonable ad litem attorney fees determined by the Court. TAX CODE §33.48(a). These charges usually include a title search fee, which is not set by statute, and which must be proven to be reasonable.

Liability. The person who owns title to the property on January 1 of the year for which the tax is imposed is liable, *in personam*, for payment of the taxes, and selling the property after January 1 does not absolve the owner as of January 1st of the tax liability. In other words, personal liability for *ad valorem* taxes does not transfer with title. TAX CODE

¹ Under certain circumstances involving taxes on personal property, the attorney fee can be imposed before July 1st. TAX CODE §33.11.

§32.07(a). A current owner may not, however, be held personally liable for any taxes assessed before he owned the property. *City of San Antonio v. Toepperwein*, 133 S.W. 416 (Tex. 1911).

Contracting with a third party for the payment of taxes does not relieve a property owner of personal liability. *Robbins & Co. v. Roberts*, 610 S.W.2d 854 (Tex. App. – Amarillo, 1980, ref. n.r.e.)

Unlike an owner of real property, a person who buys business personal property – that is, the assets of a business – *can* be held personally liable for unpaid taxes that became delinquent before the sale up to the amount of the purchase price. TAX CODE §31.081. The statute requires a buyer of business assets to retain from the purchase price an amount equal to the amount of delinquent taxes. This is something to remember when drafting asset purchase agreements.

Trial Matters

Parties. All taxing jurisdictions covering the area in which the subject property is located and to which delinquent taxes are owed may be parties to a tax suit. The original suit may be filed on behalf of one or more entities, and any other taxing units claiming delinquent taxes may join the suit. These “other taxing units” are free to intervene in the suit “without the necessity of further citation or notice to any parties to such suit.” TRCP, Rule 117a(4).

A plaintiff filing a delinquent tax suit “shall join other taxing units that have claims for delinquent taxes against all or part of the same property.” TAX CODE §33.44(a). Failure of a taxing unit to intervene in a suit before final judgment extinguishes the lien of that entity. TAX CODE §33.44(c).

It is unclear whether an intervening taxing jurisdiction must send notice of its intervention to a defendant before trial. Professional etiquette says that they should. But, as a practical matter, an intervenor’s petition is often filed within a few days before a trial setting. So, beware – find out if all taxing units named in the citation have filed papers in your case. A call to the plaintiff’s counsel is probably the best means of finding out. Online review of the court’s file may also be useful.

The persons who are appropriate defendants in a tax suit include not only the title owner(s) of the property as of January first of each year for which taxes are sought, but all persons owning any interest in title to the property at the time of the suit, and all persons claiming a lien interest of any character.

While a lien holder is not personally liable for payment of the delinquent taxes, the lien holder has a constitutional right to be served in the suit because the suit can result in the extinguishment of the lien. *Murphee Property Holdings, Ltd. v. Sunbelt Savings Assn. of Texas*, 817 S.W.2d 850 (Tex. App. – Houston [1st Dist.], 1991, no writ). Such lien holders are not liable *in personam*, but judgment against their interest in the property, *in rem*, may be entered. As the tax lien is superior, the inferior lien will be extinguished by the tax foreclosure sale. In most cases, the petition and/or citation will note that a lien holder is joined as “in rem only” to designate that personal liability is not asserted as to that party.

If you have a lien holder as a client, your client may be named a party in a tax suit if there is no release of the lien on record—even if the lien debt is barred by limitations. Generally, filing a lien release and serving a copy on opposing counsel will result in the nonsuit of a lien holder.

Missing or unknown parties. It is not uncommon for a title search to reveal the name of a person who cannot be located or is deceased as an owner of an interest in real property. Even so, those persons must be named as parties. If the whereabouts of the party are unknown or, if the party is known to be deceased, the identities of the party’s heirs at law cannot be ascertained, publication citation on such persons may be ordered. TRCP Rule 109, 109a.

Per TRCP Rule 244, the court must appoint an attorney *ad litem* to represent the interests of a party who has not answered after having been served under TRCP 109. TAX CODE §33.475 requires an *ad litem* attorney appointed in a delinquent tax case to submit a report describing the actions taken to locate and represent the defendant. If such a report is not filed, the court may not award a fee to the appointed attorney. The Harris County district courts have established guidelines for the duties required of appointed *ad litem* attorneys, including a template for an affidavit to be furnished in each case. These guidelines and forms may be accessed via the tax masters’ web pages at WWW.JUSTEX.NET/COURTS/CIVIL.

Answer. It should go without saying that you should file a written answer. The most viable defenses to tax suits are affirmative defenses—so don’t forget to plead them (see below). TRCP, Rule 94.

Affirmative Defenses That Work.

1. Non-ownership of real property on January 1 of the appropriate year. TAX CODE §42.09(b). [see above regarding business personal property]
2. The property is/was not situated within the taxing jurisdiction claiming the taxes. TAX CODE §42.09(b).

3. Payment of the taxes and any lawful penalties, interest and costs.
4. Limitations. TAX CODE §33.05
 - a. For taxes levied against real property, the limitation period is 20 years.
 - b. For personal property taxes the limitation period is 4 years.
 - c. Limitations begin running on the date taxes become delinquent.
5. Although it is technically not a defense, if the taxes sought are levied against the residence homestead of your client who is either 65 years of age or older or is disabled, the suit will be abated and collection of taxes deferred. TAX CODE §33.06. Be certain to claim the deferral by filing an application with the appraisal district, and so stating in the answer.

Remember the personal liability issue. If your client is not a fee title owner of the property and has not been named “in rem only”, then you should raise that issue in a pleading.

Defense based on lack of notice. Section 33.04 of the TAX CODE requires certain notices of delinquency to be mailed to property owners. In certain cases, failure to send these notices can result in the postponement of the delinquency date.

Defenses That Do Not Work. The TAX CODE is worded to strongly favor taxing authorities, and tax amounts cannot usually be litigated after delinquency. The following defenses have been tried without success:

1. “The property is over-valued.” The District Court is without jurisdiction to alter a valuation that has not been timely appealed per TAX CODE §42.01. *But see, General Electric Capital Corp. v. City of Corpus Christi*, 850 S.W.2d 596 (Tex. App. – Corpus Christi, writ den.) relating to inventory.
2. “We’ll pay the taxes, but the penalties are outrageous.” Sorry, but the penalties are statutory and mandatory. But, see above regarding delinquency notices.
3. “I don’t have to pay the tax” because:
 - a. I just don’t have the money;
 - b. Texas was never properly annexed into the U.S.A., so it cannot levy or collect taxes;
 - c. The government does not spend my taxes wisely;
 - d. Taxes became invalid when the US went off of the gold standard;
 - e. All land belongs to God, and is therefore exempt from the laws of man.

Evidence. Certified tax statements are admissible without further predicate and are *prima facie* evidence of the tax due. The certified tax statements admitted into evidence also stand as proof that the taxing units “complied with all requirements of law” pertaining to the levy of the taxes and the prerequisites established by law for the collection of penalties

and interest provided for by statute. TAX CODE §33.47. The presumption is rebuttable, and the defendant assumes the burden of proving payment, lack of notice, or any other defense. *National Medical Financial Services, Inc. v. Irving Indep. School Dist.*, 150 S.W.3d 901 (Tex. App. – Dallas, 2004).

Discovery. Discovery is allowed in tax cases just as in other civil suits. You might want to consider serving discovery if your client has made partial payments, but is uncertain whether credit is reflected in the tax statements. In that case you may want to seek detailed accounting information because the tax statements provide little detail.

Although discovery is allowed, in most cases informal means of gathering information may be more cost effective. First, try discussing the matter with counsel for the taxing unit on the telephone. Unfortunately, this is often frustrating. Nevertheless, it is usually more practical and efficient for defense counsel to confer with plaintiff's counsel about the case instead of filing lots of discovery requests.

Judgment. The judgment in a tax case will award monetary amounts for all taxes that were delinquent on the date of the judgment, all accrued penalties and interest, collection costs (attorney fees, title search fees, etc.) and court costs.

The judgment will be entered in favor of all taxing jurisdictions that are joined in the case as plaintiffs and intervenors. All owners of an interest in the taxable property, including lien holders and persons appearing in the chain of title, should be named as defendants in the judgment. Those holding lien interests should be shown as “in rem only”, which indicates that the defendant will not be personally liable for any deficiency.

The judgment will set forth the “adjudged value” of the property. TAX CODE §33.50. This is the market value of the property on the date of the judgment. If this adjudged value is less than the amount of the taxes and other amounts awarded in the judgment, then it will be the amount of the minimum bid that will be accepted at a public tax sale. Wise defense counsel should consider contesting the “adjudged value” at trial.

The judgment will also order the foreclosure of the tax lien by allowing the property to be sold at a public tax sale. A tax sale is held in the same manner as other foreclosures, under an order of sale issued by the District Clerk. TAX CODE §§33.53, 34.01. A sheriff's deed will be issued, and a writ of possession will issue to the successful purchaser. TAX CODE §33.51.

If the property does not fetch the “minimum bid” (the lesser of the amount of the judgment or the adjudged value), the taxing unit requesting the sale may terminate the sale or it

may have the property “struck off” to it and the minimum bid amount will be credited against the judgment. TAX CODE §34.01(j).

The sale of a property extinguishes all TAX liens, but does not affect the personal liability of a fee owner for the payment of any amount not satisfied from the sale proceeds. TAX CODE §34.01(q).

When a taxing unit acquires title to a property through a tax sale, no tax lien attaches to the property for taxes that accrue after the taxing unit acquires title. *State v. Moak*, 207 S.W.2d 894 (Tex. 1948).

Final Judgment. A tax judgment may be vacated if it is defective in any one of several ways even after it becomes final under the Texas Rules of Civil Procedure. See TAX CODE §33.56. So, your client may think it’s all over only to find years later that the suit has been revived. This can occur only if there has not been a sale to a third party, or if the purchaser at the sale consents. Caveat: a tax judgment can be vacated if the property is “struck off” to a taxing jurisdiction. There is no authority that addresses whether taxes accrue during the period that title to the property is held by the taxing jurisdiction; logic, however, would seem to dictate that no taxes accrue while title is held by a public entity.

VII. Other Amounts

Claims for amounts other than taxes imposed entities on real property by governmental can be included in a tax suit. These are commonly known as “special assessments”. Special assessments relate to the real property that is the subject of the tax suit and they are imposed under one or more of the following:

- a. paving liens – Transportation Code §311.092
- b. demolition of dangerous structures – Local Government Code Ch. 214
- c. weed cutting – Health & Safety Code Ch. 342
- d. sewer improvements – Local Government Code Ch. 402
- e. water district standby fees – Water Code

The special allowances afforded in tax claims do not apply to special assessments. That is, there does not appear to be a provision that a certified statement reflecting a special assessment will be regarded as prima facie proof. Likewise there is no statutory provision that mandates the award of attorney fees in any specific amount. One may therefore require proof on these claims. On the other hand, there is no limitation period set out in the above statutes, and therefore no limitation exists. See TEX. CIV. PRACT. & REM. CODE §16.061.

IX. Settlement

As in all cases, settlement is encouraged, but cannot be required by the court.

Installment agreements are permitted (but not mandated) by Tax Code §33.02. They may not exceed 36 months in duration and do not abate penalties or interest. Execution of an installment agreement constitutes an admission of liability and tolls limitations.

A possible matter for negotiation is the “adjudged value” to be recited in a judgment. The lower the amount, the more likely the property is to sell at a Constable’s sale. While a party having personal liability can be pursued for a delinquency if a property sells for less than the judgment amount, as a practical matter deficiency suits are rare.

Mediation is not practical in a delinquent tax matter for two reasons: (1) taxing jurisdictions may not be required to pay costs, such as a mediator’s fee (TAX CODE §33.49); and (2) the amounts involved cannot be compromised.

Discounts. Forget it. Discounts are prohibited by the Texas Constitution. Art. 3 §§51, 52; Art. 8, §10.

X. Post Judgment

Tax Sales. Tax foreclosure sales are conducted as are other judicial sales. TAX CODE §34.01. The property is sold to the highest bidder for cash, provided that a bid exceeding the “minimum amount” is received. The minimum bid amount is the lesser of the adjudged value of the property as stated in the judgment and the amount of all taxes, penalties, interest and costs set forth in the judgment. TAX CODE §34.01. If no bid for the minimum amount or more is received, then the property is “struck off” to the taxing unit. TAX CODE §34.01(c).

Redemption Right. An owner whose property has been sold at a tax sale has the right to reclaim the property by paying to the purchaser at the tax sale the purchase price, plus an additional amount. TAX CODE §34.21. The right to redeem persists for 2 years after the date of the sale for residential homestead property, agricultural land or mineral interests, and for 6 months for other real property. If homestead, agricultural or mineral property is redeemed within the first year after the sale, the “premium” due the buyer is 25% of the sale price; if paid during the second year after the sale, the additional amount owed is

50% of the price. If other real property is redeemed within the 6 month period, the additional amount due is 25%.

Excess proceeds. If a tax sale yields funds in excess of the amount of the judgment, plus collection costs, then the excess sale proceeds are placed in the registry of the court. The proceeds are subject to claims pursuant to TAX CODE §34.04, and the statute provides a priority ranking for the distribution of the excess proceeds.

Taxes accruing after the date of judgment and before the sale may be collected from the excess proceeds. Lien holders have priority over former property owners, so if you represent a lender, there is good reason to make a claim against the “excess proceeds.”

To claim all or a portion of the excess proceeds, a petition must be filed within 2 years following the date of the sale of the property. The statute specifies the matters that must be asserted in the petition and the parties who are entitled to notice. If funds remain unclaimed after the expiration of the two year period, the funds escheat to the taxing authorities.

XI. Hints

The most economical course of action is to help your clients avoid a delinquent tax suit. There are a few very simple things that can be done toward that end:

1. Make sure the Appraisal District has your client’s current address. This can be checked at www.hcad.org. If it appears that the listed address is incorrect, a form for correcting the tax rolls can be downloaded from the same site.
2. TAX CODE §22.01 requires an owner of business personal property to file a rendition each year before April 15th. Failure to timely file a rendition report incurs a penalty equal to 10% of the tax owed on the property. TAX CODE §22.28. Again, forms for rendition reports are available on the HCAD website.
3. You may file a “Report of Decreased Value” for property that has decreased in value since the preceding year. TAX CODE §22.03. This may head off a protest.
4. Watch for notices of valuation sent out by the appraisal district in the early months of the year and do not miss the deadline to file a protest, which is ordinarily May 31st.
5. When representing a buyer of business assets, be sure that all delinquent taxes are paid from the proceeds of the sale, or your buyer may become liable for the taxes incurred before the sale.

What is Tax Court?

Approximately 35% of all non-family civil cases filed in Harris County are delinquent tax cases. Some of the District Judges of Harris County have established a tax court under the provisions of TEXAS TAX CODE §33.71, by appointing two individuals to serve as masters in chancery to hear delinquent ad valorem tax disputes. The tax court's purview is limited to delinquent tax cases. The tax masters are not authorized to review valuation issues, even if those issues have been properly brought in court.

The tax masters do not conduct jury trials; if a jury fee is paid, the case will be referred to the District Court for trial. TAX CODE § 33.76. The tax master is permitted to examine witnesses, and to conduct pre-trial matters. The master reports her recommendation regarding final action to be taken to the District Court. TAX CODE §33.71. Thereafter, the District Judge signs any order or judgment deemed appropriate.

Any party may appeal the recommendation of the tax master to the referring district court. TAX CODE §33.72. Notice of the right to appeal may be given in open court or in writing.

The appeal is brought by giving written notice of appeal within ten (10) days following the date of the tax master's recommendation. The notice of appeal must specify which of the tax master's findings or conclusions are the subject of the appeal. The appeal is heard *de novo* in the district court, and only the issues stated in the notice of appeal are reviewed. The district court is required to hear an appeal from the tax court within 45 days following the date the notice of appeal is filed. TAX CODE § 33.74. There is no fee or bond requirement.

Failure to appeal the tax master's recommendation does not preclude an appeal of a final judgment to the Court of Appeals. TAX CODE §33.74 (i).