TO: MEMBERS OF THE COMMITTEE ON REVENUE
FROM: GEORGE KILPATRICK, COMMITTEE COUNSEL
RE: LR 307 TAX SALE CERTIFICATE PROCEDURES
DATE: NOVEMBER 8, 2004

***Summary** – A majority of states do not sell tax sale certificates prior to foreclosure to collect the debt. The tax sale certificate process in Nebraska is very much in the mainstream among those states that do have such a process. There is a great variety among the states in practices and procedures and Nebraska could approach this process differently using another state as a model. Certificates could be sold to the highest bidder, bidders could bid on the basis of the interest rate they are willing to accept, the redemption period could be shortened, or the interest rate lowered. Also, the Legislature could consider eliminating the process altogether, leaving the county in charge of collecting delinquent taxes through foreclosure rather than selling the certificates.*

Nebraska process – Under NEB. REV. STAT. SECTION 77-1801, all real property which has been assessed taxes that are delinquent shall be subject to sale on the first Monday in March. Public notice is to be given prior to sale. The land is to be "sold" to whoever is willing to pay the taxes and the interest thereon. From a practical standpoint, since the amount paid is known for all properties, the tax sale properties are merely allocated among those willing to pay either randomly or by taking turns. After the sale, the purchaser pays the taxes and interest due and receives a "tax sale certificate" for the amount. The amount received is then distributed to the taxing subdivisions as the taxes were to be distributed. If the purchaser can't make payment, it is resold (section 77-1808).

The county takes a certificate for all properties that remain unsold. The county may sell these certificates to another party at any time for the amount then due, including any additional interest. (Section 77-1809) Other political subdivisions have the first option to purchase the certificates over any property, unless a certificate for the property had previously been sold to another buyer. (Section 77-1810).

The county treasurer issues a "certificate of purchase" to any buyer and must keep track of the purchasers of all such sales. These "certificates of purchase" are usually called "tax sale certificates". They may be resold to another party by the purchaser, and those sales must be reported to and recorded by the county treasurer.

Despite all the language in the statutes regarding "purchase" and "land sold for taxes" these sales are not really sales of land and these certificates do not entitle the purchaser to use the land, at least not immediately. Tax sales certificates are written and publicly recorded liens against real estate for the payment of a debt, the amount being the amount of delinquent taxes plus interest. The certificates accumulate additional interest at the delinquent property tax interest rate of 14% (section 45-104.01). This is what makes them attractive investments so long as the value of the land is sufficient to cover the amount of the debt. However, in most cases, the purchaser of the certificate is not interested in the land itself. He or she is likely interested only in the return on the debt and has no intention of ever taking possession of the land. The treasurer charges the purchaser a $10 fee for issuing the certificate.

The owner of the property may redeem the property by paying the taxes and interest to the county treasurer, not the holder of the certificate. The county treasurer then records the redemption and sends the amount due to the holder of the certificate. The county treasurer charges the redemptioner $2 for this action. (Section 77-1825)

The purchaser of a tax sale certificate may obtain a treasurer's deed for the property after a redemption period of three years (section 77-1837), or longer for a minor or an incompetent person. The certificate expires six months later so there is only a six month window to obtain a deed. Before the deed may be issued, personal service to the owner must be attempted by certified mail (section 77-1832). Upon failure of service, published notice for three consecutive weeks will serve as notice (section 77-1834).

In lieu of taking a tax deed, the holder of a tax sale certificate may enforce his or her rights through foreclosure (section 77-1901 et. seq.) Foreclosure is also available immediately for land for which the tax sale certificate was issued to the county for want of bidders at the sale. One difference is that the transfer to another owner shall not be considered final until two years after the sheriff's sale if the sale is for the benefit of the county while the sale is final immediately if the sheriff's sale is to foreclose a tax sale certificate. Foreclosure proceedings also require individual or published notice.

If the taxes remain unredeemed after all the appropriate notices are provided, the sheriff shall set a time for the sale and sell the property. The district court must affirm that the procedural requirements have been met and confirm the sale (section 77-1913). Thereafter, the court certifies the sale to the county treasurer, who is to cancel the taxes for the years involved. The proceeds from the sale are to first go for the expenses of the court and sheriff in conducting the sale, and then to the holder of the tax sale certificate for the amount of the taxes and interest. Any surplus would go to the owner of the property if known as is the case with any other foreclosure (section 77-1916).

Other State's Approaches – A 50 state statute review shows that about one third of all states have a tax sale certificate process as a method of collecting delinquent taxes.[1] Most of the rest commence with a judicial process for collection. The county or another political subdivision files suit in District Court alleging that the property taxes are delinquent and that the land should be sold to satisfy the obligation. Notice and other due process requirements occur at this time. The owner may appear and contest the levy or

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[1] In carrying out the requirements of LR 307, I quickly reviewed the statutes of all 50 states and the District of Columbia, using *State Tax Onedisk.* This is a searchable CD produced by Tax Analysts that contains statutes, regulations, summaries, tax rates, forms, and Supreme Court Opinions from all 50 states and a number of U.S. territories. It was produced in 2001, so the information is 3 years old. What I did was word search the statutes of each state (and D.C.) using the key words tax, with certificates, and tax with deed. When I reviewed the hits, I found the one or more dealing with delinquent taxes and then scrolled forward and backward to try get the jist of the statutory process in that state.

the allegation that they are unpaid. Ultimately, the land is sold at a sheriff's sale, usually subject to a right of redemption for a relatively short period of time, such as 6 months.

In the judicial states, the taxes must usually have been delinquent longer than in tax sale certificate states. Two to three years is probably average. Therefore, the advantage of a tax certificate process is that the governments get the money sooner, and the due process rights are satisfied during the time a certificate is held. Under a judicial process, the governments must do without the money until all of the rights of the owner have run and title to the land may be transferred.

There is a great deal of variation in how this process is carried out. A couple of examples may be helpful. In Oregon after the land is delinquent three years and after 3 month's notice, foreclosure is commenced and the land is ultimately transferred to the county. The county holds it up to 2 years, during which time it can be redeemed. After that time, it becomes surplus property owned and sold by the county. The total time could be five years.

On the other hand, in Pennsylvania the claim is filed on July 1st after delinquency. This claim is absolute and can't be challenged after July 1. The court may order possession for the purpose of collecting any rents on January 20th and the property may no longer be redeemed after the following July 1. The entire process takes only 1 year. In New Mexico, the taxes must be delinquent for three years to commence the judicial process, but there is no redemption process available.

In Missouri, the land must be sold within three years of delinquency to a resident or a person with a local agent. The purchaser may seek possession within 1 year, but the property may be redeemed through a judicial process within two years after sale. Any surplus is held in the school fund for 7 years. Finally, in Tennessee, the county is to contract with attorneys to collect tax liens. Once proved to be delinquent, the court is to order the land sold. The redemption period is only one year, but the fact of delinquency and process cannot be challenged after three years after the sale.

There are a handful of states that use an administrative process to sell the land. States that use this type of process tend to be more urbanized and the process is completed much faster. For example, in Massachusetts land that has delinquent taxes pending is sold by the town at a public auction to the highest bidder. The town takes title to any property that is unsold. The purchaser or town receives a deed. This deed may be foreclosed upon six months after the sale. The District of Columbia also has a six month redemption period. In Vermont, the tax collector sells the land and it may be redeemed by the original owner within one year of the sale.

On the other hand, in Hawaii the land is sold administratively once the taxes are three years delinquent. There is no redemption period thereafter. Utah is similar, except the taxes must be four years delinquent.

Other States with Tax Sale Certificate Processes – Of the seventeen or so states with an intermediate step of selling tax liens or certificates prior to selling the land, Nebraska's is in the mainstream. Iowa, Kentucky, Louisiana, Michigan, Montana, Oklahoma, and Wyoming all have similar processes although the redemption periods and interest rates vary. Michigan's redemption period is one year while Wyoming's is four years. The interest rate on the certificates varies from 8% in Oklahoma to 18% in Wyoming.

In a few states, bidders for the certificates bid on the basis of the interest rate. In other words, the bidding starts at a low interest rate and the bidding goes up until the certificate is sold to the buyer that is willing to accept the lowest interest rate. Florida, New Jersey, North Dakota, and South Dakota are examples of states that use this method.

A few states auction tax liens or certificates to the highest bidder. In other words, the bidders may be forced to pay a premium to get certain certificates. Alabama, Colorado, and West Virginia are examples. In these cases, any premium paid is treated like a surplus when the property is sold for an amount greater than what is necessary to pay taxes, interest and costs. It is held in escrow awaiting a claim from the owner and eventually escheats to the county if unclaimed. If the property is redeemed, any surplus is returned to the holder of the certificate (the one that paid the premium).

Finally, there are several states where the county or town takes the certificate (or tax deed) for the redemption period. The land is then either sold or used by the county at a later time. Like the judicial examples, the chief disadvantage is that the governments do not receive the taxes throughout the redemption period. In Idaho, the county holds the tax deed for three years. In Nevada, the county is issued a tax certificate for two years (although it can be sold to a third party) and then receives a tax deed. In Wisconsin, the county holds the tax certificate for the two-year redemption period. After that, the county may either take title or foreclose by going to court for a sheriff's sale.

In Washington after the property is delinquent for three years, the county gets a "certificate of delinquency" which is filed with the District Court. After notice and a summons to the owner, the Court transfers title to the county and service notice that foreclosure will commence in 30 days. The land cannot then be redeemed after foreclosure.

Rhode Island has a mixed procedure. First, the towns receive a deed of taking upon delinquency. Then these deeds are sold. One year later the right of redemption may be foreclosed through a judicial procedure.

Summary – There are a number of different procedures that are used by the various jurisdictions. In fact, each state is a little bit different. All provide sufficient notice and process to delinquent taxpayers, although in some cases, due process procedures are at the beginning and others at the end. States with tax sale certificate processes provide notice and due process at two stages, but succeed in getting the money to the local governments that levied the taxes quickly, even if the final disposition is years away.

Nebraska's tax sale certificate\tax deed procedure is very much in the mainstream as it is. Interest rates vary from 8% to 18% and redemption periods vary from 6 months to five years. Nebraska's interest rate is 14% and the redemption period is 3 years.

Possible Changes to Consider – Past legislation referred to the Revenue Committee has looked at three aspects of this process. The purpose behind these proposals has seemed to be to make certificates less attractive for investors, especially out of state investors.

Change the interest rates - First, we have heard a number of proposals over the years to lower the interest rate, or peg the property tax interest rate to national interest rates such as is the case for the interest rate for delinquent state taxes. Objections have come from counties that do not wish to lower the interest rate and increase the likelihood that taxpayers may choose to borrow money from the county by not paying the tax rather than borrow from other sources.

However, a lower interest rate on delinquent taxes does not necessarily mean a lower rate on tax sale certificates. The Legislature could set a different interest rate or have a floating interest rate on the certificates and maintain the current rate on delinquent taxes prior to sale of the certificates. A few states, including South Dakota bid on the basis of interest rates. Nebraska could consider this system.

Sell certificates to the highest bidder – The Legislature could also consider allowing tax sale certificates to be offered to the highest bidder. Because the certificate represents only an indebtedness for the amount of the taxes and interest, many investors will pay no more than the face value. Some purchasers might be willing to pay a premium for the certificate to lower the effective interest rate if they still feel it is a good investment. Other bidders may be willing to pay more because they actually want ultimate title to the property.

Either way, selling certificates to the highest bidder creates a surplus which, in most states that have this practice, must be held in escrow by the county until either the land is redeemed or a deed is delivered. If the property is redeemed by the owner, the purchaser of the certificate receives back any premium paid. If the purchaser secures title, the delinquent owner should receive any surplus. In most other states with this approach, counties usually receive any unclaimed surplus through escheat after a certain length of time, although in Louisiana any unclaimed surplus escheats to the state.

Increase the price – Many bills in recent years have proposed to increase the price counties charge for tax sale certificates. Last year's LB 857 proposed an increase from $10 to $25. Many state statutes do not levy a particular charge for tax sale certificates, but are allowed to attach their actual costs to the price of the certificate.

Shorten the redemption period – While this proposal has not been introduced into the Legislature in at least the past 15 years, some states do have shorter redemption periods. Because a 14% interest rate for 1 year might be less attractive than for three years, shortening the redemption period could mean that bidders are more likely to be interested in the land than the interest, at least when compared to the current situation. This could work alongside proposal to sell certificates to the highest bidder.

County takes the certificates – In several states, the county takes the certificates and the indebtedness. In these instances, the county rather than an investor benefits from the 14% delinquent property tax interest rate. On the other hand, the taxing units do not have access to the money while the redemption period runs and the county bears the expense of collection through foreclosure or sale of the property if it takes a tax deed.

Eliminate the process – a majority of states do not have a tax sale certificate process. Instead the county must go to court to collect taxes through foreclosure. This proposal would have the same advantages and disadvantages as the county retaining the certificates.