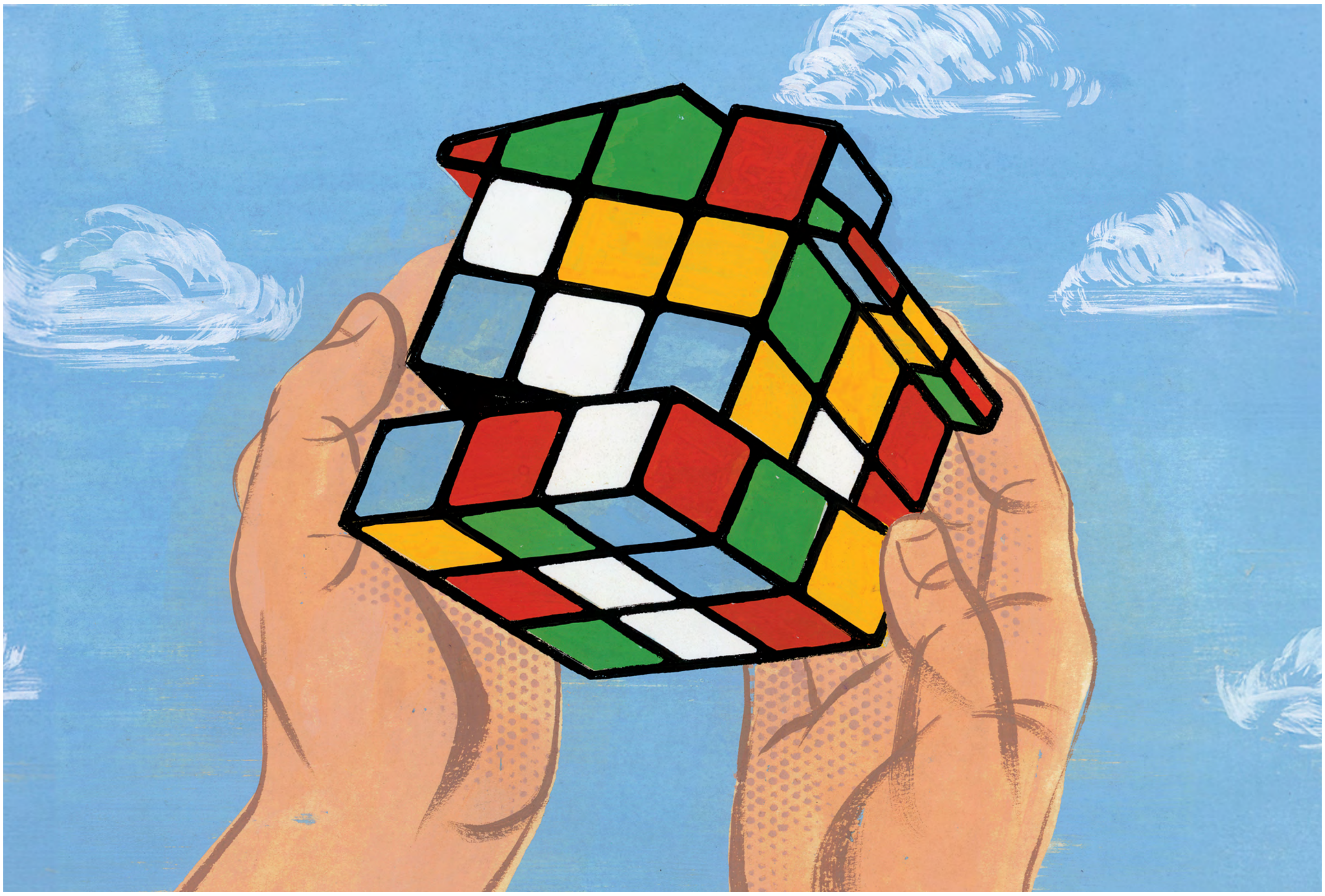

State by State Solutions

How states are revising property tax foreclosures after *Tyler v. Hennepin County*

BY MATTHEW A. ABEE AND JONAH SAMPLES

Tax sales have traditionally played a key role in the administration of government finances. Tax sale statutes empower state, county, and local governments to collect delinquent taxes by placing liens or selling tax deeds for the property of taxpayers who have accumulated unpaid taxes. These statutes are essential for collecting property taxes—what some courts have called the "lifeblood" of local government—and, in turn, for funding of public services. Tax sales also bring in investors that purchase the properties or liens (depending on the state), which often restores dilapidated properties and returns income-producing properties back on the tax rolls. So, while the tax-collection process may be viewed by some as archaic, that process often results in modern reinvestment in the community. Yet, the recent Supreme Court decision of *Tyler v. Hennepin County* may impact the legality of many statutory schemes across the country.

The Supreme Court's opinion in Tyler

In 2023, the Supreme Court ruled that a Minnesota county's tax foreclosure sale could only be used to recover what was owed to the government, but not more. Put another way, a tax foreclosure process that leaves no options for a delinquent taxpayer to protect the difference between the value of the property and the delinquent taxes owed—known as the surplus—violates the Takings Clause of the Fifth Amendment to the United States Constitution.[1] This Supreme Court case was brought by 94-year-old Geraldine Tyler, who owned a condominium in Hennepin County, Minnesota. The condo accumulated roughly $15,000 in unpaid real estate taxes, along with interest and penalties. After a nearly four-year process, replete with notices to Tyler and others, the title to the property forfeited to the county by operation of law (but not a public auction). After repairing the property at its own expense, the county then sold it for $40,000, keeping the $25,000 surplus.

Procedurally, the case rose to the Supreme Court based on the trial court's dismissal. Consequently, the record was minimal, and the court didn't consider whether the presence of other liens on the subject property (such as a homeowners' association lien) could negate Tyler's claim of "excess value." This procedural posture also limited the court's ability to resolve additional questions lingering in the background of the case.

The Supreme Court subsequently ruled that there must be an opportunity for property owners to recover any value in the property that exceeds the amount owed, invalidating Minnesota's treatment of the surplus.

Unfortunately, the court provided little guidance for how local and state governments may implement the decision on a broader scale.

Nationwide implications?

Unfortunately, the court provided little guidance for how local and state governments may implement the decision on a broader scale. This is especially true for states that have tax-foreclosure processes that vary from Minnesota's forfeiture method at issue in *Tyler*. For example, when *Tyler* was decided:

- Alabama taxpayers had no right to the surplus unless they paid to redeem the property under the traditional tax deed method used by many counties.
- South Carolina taxpayers were able to claim the overage through the local tax collector for a period of five years before those funds escheated to the county.[2]
- West Virginia taxpayers could claim the surplus within two years of confirmation of sale.[3]
- Georgia surplus funds not claimed within five years were paid to the Department of Revenue and only an interpleader action could release the funds.
- Arizona taxpayers had no right to a surplus as one was not generated by the public auction of tax liens on the property, rather than public auction of the title to the property.

These are only a few of the numerous ways that state tax sale statutes varied in their treatment of surplus funds (or value) when Tyler was decided. As a result, many states may be wrestling with the question of whether Tyler even applies to their particular tax-collection statutes.

Unanswered questions

Advocates of the *Tyler* decision argue that it calls for reforms of "home equity theft." Yet the opinion does not use the phrase—in fact, it only mentions "equity" once. And in any event, the court's opinion provides little guidance to states on what exactly constitutes "theft." The court left open sticky questions about how to properly value the perceived thievery, and who could properly be considered thieves (as in, whether private tax lien bidders could be considered private "state actors" for the purpose of the takings analysis). (Because the county conducted the taking in *Tyler*, the court was not presented with this with this issue. But a companion case, *Fair v. Continental Resources*, No. 22-160, was remanded to the Nebraska Supreme Court shortly after *Tyler* and may soon confront this issue.) The court also didn't analyze whether a delinquent taxpayer's ability to sell the property under state law—even during tax foreclosure proceedings—as a self-help alternative to facing a forfeiture could impact the takings analysis.

The Supreme Court also didn't decide what options or procedures must be available to delinquent taxpayers to recover the surplus to avoid this hypothetical crime, or what period of time a surplus must remain available to be constitutional. This last unanswered question impacts nearly every state in the country. For example, in Arkansas, surplus funds escheat in as little as two years, but in Maryland, the period is three years; in Nevada, one year; and in New Jersey, five years.[4] Therefore, if a state chose to allow a taxpayer to petition for the rights to the surplus, states will need to be cognizant that even then there is still no one-size-fits-all solution for constitutionality in light of these unanswered questions.

A potential exception: the public-auction option

The court also left open the question of whether a prior 1956 case, *Nelson v. City of New York*, could serve as a potential avenue for protecting the constitutionality of a state's tax-foreclosure statutes. *Nelson* involved a statute which permitted New York City to initiate foreclosure proceedings to collect unpaid water charges on two parcels of land held in trust. The statute required notice by posting, publication, and mailing to the trust estate. Because of a bookkeeper's negligence, however, the notices weren't brought to the attention of Gerald D. Nelson, the managing trustee. Consequently, judgments of foreclosure were entered, and the city acquired title to the property. One parcel was sold for an amount exceeding the unpaid water charges, while the city retained the other parcel. The Supreme Court held that an ordinance requiring a property owner to file a timely answer in a foreclosure proceeding for unpaid water bills or risk forfeiting the right to future surplus did not amount to a taking within the meaning of the Fifth Amendment.

The *Tyler* court explicitly notes that the Nelson decision was not overruled, because unlike "in Nelson, Minnesota's scheme provides no opportunity for the taxpayer to recover the excess value; once absolute title has transferred to the state, any excess value always remains with the state." Accordingly, requiring that the owner file a timely answer in the foreclosure proceeding that asserts the property has a value substantially exceeding the tax due as a prerequisite for recovering the surplus amount is an option that can likely be employed to comply with the *Tyler* decision.

Adopting the *Nelson* strategy to comply with *Tyler* is an option that must be evaluated within the statutory scheme of each state. This is especially true given that each state may seek to preserve as much of its previous statutory scheme as possible. But *Nelson* does seem to open a door for a simplified solution for states to comply with the *Tyler* decision. The ordinance challenged in *Nelson* did not "absolutely preclud[e] an owner from obtaining the surplus proceeds of a judicial sale." The ordinance defined the process through which the owner could claim the surplus, which within the meaning of *Tyler* is still permitted. It is important to note that states also have varying time periods that mark when the funds escheat, which might be a factor in determining the constitutionality of a *Nelson*-esque solution.

In the wake of *Tyler*, at least one federal court has concluded that *Nelson* remains good law and insulates tax foreclosures from similar constitutional attacks. In *Metro T. Properties, LLC v. County of Wayne*, the United States District Court for the Eastern District of Michigan rejected a challenge to Michigan's General Property Tax Act (most recently revised in 2020, three years before *Tyler* was heard by the Supreme Court). The District Court discussed *Tyler* and *Nelson* at length, ultimately concluding that the express statutory mechanism for claiming surplus funds prevented the constitutional challenge to the tax sale statute as a whole. So, providing delinquent taxpayers with the option to demand a public auction—or at least the option to somehow claim the surplus, even for a short period of time—may be the answer to the questions left open by *Tyler*.

The legislative fix

Because the Supreme Court does not clarify when and how states may need to react in the wake of *Tyler*, it is unclear which states may need to revamp their treatment of tax-sale surpluses. States having no method for generating a surplus or no procedure for allowing a delinquent taxpayer to claim the surplus, however, are the likely targets for *Tyler*-like challenges. Without some procedural or legislative change, these states may have tax foreclosures that are later deemed unconstitutional.

Many states are investigating legislative fixes, but that path is not always easy, or quick. Reforming state statutes involves balancing the interests of investors and taxpayers. States made policy decisions in enacting their current statutes, often with the intent or promoting productive use of the land. Protecting the rights of taxpayers is certainly a concern of the states that is reflected within their statutory schemes, as delinquent taxpayers are still entitled to the constitutional rights guaranteed them as it relates to property ownership and procedural safeguards under court rules. In such situations, implementing less-restrictive sales with fewer safeguards may prevent the protection of the taxpayer, but states must still administer state functions and promote productive use of the land. To balance these interests, each state has a statutory scheme that accounts for these factors. For example, several states, such as Kansas and Texas, provide more time for redeeming after sale for homeowners than of businesses.[5] These considerations have traditionally been used to strike a balance between facilitating tax collection and protecting the rights of delinquent taxpayers. However, in the wake of *Tyler*, many states are scrambling to preserve as much of these considerations as possible without clear guidelines.

These are all questions that the Supreme Court left open, and they require legal analysis and clarification. Furthermore, the methods used to collect delinquent taxes vary because states differ on whether the state itself, counties, or municipalities should be tasked with the balancing of these competing interests. These methods have been chosen by each state as a part of a comprehensive statutory scheme that was consciously chosen and implemented. The *Tyler* decision changes the atmosphere of these decisions.

Since *Tyler*, states have varied in both the speed and type of legislative action they have taken. Given the nuances involved, balancing both the Tyler and Nelson decisions can be difficult. In New Jersey, lawmakers have moved quickly. The N.J. Appellate Division court found in *257-261 20th Avenue Realty, LLC v. Alessandro Roberto*, that New Jersey's tax sale law allowing the state to retain a property owner's equity when a tax lien is foreclosed was unconstitutional and violated the Takings Clause as described in *Tyler*. That decision is still on review, and it remains uncertain whether the New Jersey Supreme Court will intervene to narrow or even reverse the lower court's opinion.

That said, since the *Roberto* decision, the New Jersey legislature has introduced several bills proposed to repeal R.S.54:5-33—the law raising concerns over constitutionality after *Tyler*. These bills have varying approaches to compliance with *Nelson* and *Tyler*. Senate Bill No. 2334 would add a mechanism by which a delinquent taxpayer could request a public sale during the tax lien foreclosure process—a mechanism like the one at issue in *Nelson*. By contrast, Senate Bill No. 718 proposes that if no application is made within one year of the date that the surplus is deposited with the court, then upon application to the court by the chief financial officer of the municipality in which the property is located, the premium shall become a part of the funds of the municipality. Both bills could be solutions, but New Jersey, like many other states, must decide by listening to stakeholders and evaluating their state specific statutory schemes.

Similarly, Colorado had a policy that if the county sells the property, the proceeds were divided between several governmental entities, and the surplus was not refunded to the former owner.[6] Since *Tyler*, the Interim Legislative Oversight Committee Concerning Tax Policy and Task Force has proposed a bill which suggests changes to the Colorado Revised Statutes. The Colorado House Bill, Drafting No. LLS 24-0384 (Bill B), establishes a process by which the taxpayer may apply for a public auction, and if the public auction results in a surplus, then the amount of the overbid must be paid in order of recording priority to junior lienors, and any remaining must be paid to the taxpayer.

> There is no one-fix solution to compliance with the Tyler decision—states are moving at considerably different speeds and with varying levels of change based on their current statutes and policies.

By contrast, New York seems to be waiting to see how and if it intends to respond to the *Tyler* decision. Some counties in New York have paused foreclosures in relation to the *Tyler* decision, but others have continued and set aside surpluses into a reserve fund. This inaction may have several implications in the wake of the *Tyler* decision. New York Senator Sean M. Ryan, who chairs the state Senate Committee on Commerce, Economic Development, and Small Business, has stated that New York must address the issue this year, with counties "already facing potential liability."[7] New York may be waiting and watching for disputes arising after *Tyler* in other states before amending its current statutory scheme, but with the counties pausing certain sales, this is certainly an issue that will need to be addressed.

Conclusion

As tax sale investors navigate the intricate legal terrain of property tax delinquency and foreclosure, stakeholders should stay vigilant about the nuances introduced by state-specific legal developments to navigate the complexities of tax foreclosures. There is no one-fix solution to compliance with the *Tyler* decision—states are moving at considerably different speeds and with varying levels of change based on their current statutes and policies. In making these changes, state legislatures must carefully balance the interests of both investors and taxpayers. In the coming months and years, it would be expected that additional precedent should surface to help guide lawmakers and clarify what factors determine the constitutionality of tax sale statutes, but in the meantime, an increasing number of states will likely craft their own solutions to *Tyler* through legislative change.

Matthew A. Abee *and* ***Jonah Samples*** *are part of the Tax Lien Resolution and Litigation Team at Nelson Mullins Riley & Scarborough LLP, and they are members of the National Tax Lien Association.*

1 "Nor shall private property be taken for public use, without just compensation."
2 S.C. Code Ann. § 12-51-130.
3 W. Va. Code § 11A-3-65.
4 See Ark. Code § 11A-3-65; Md. Code Ann., Tax-Prop. § 14-819; Nev. Rev. Stat. Ann. § 361.610; N.J. Stat. Ann. § 54:5-33.
5 See Kan. Stat. Ann. § 79-2401a(b); Tex. Tax Code Ann. § 34.21(e)(1).
6 CRS § 39-11-145.
7 Danielle Muoio, "N.Y. to Rework Tax Foreclosure Sales After Supreme Court Ruling," Bloomberg Tax, January 29, 2024.