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LAW LETTER

Liens

Priority of Mortgage and Tax Liens

Buyers, sellers, lenders and brokers of real estate sooner or later confront the question of liens and lien priority. A lien is a claim or charge on property for payment of a debt or obligation. Failure to pay the debt or obligation permits foreclosure (sale) of the property. The foreclosure of a superior lien terminates all subordinate liens. Any lien surviving foreclosure reduces the subsequent sales price.

This article examines the interaction of federal, state and property tax liens with each other and with prior recorded security interests. For example, does a foreclosure on a federal tax lien eliminate an existing mortgage lien or a property tax lien on the taxpayer's land?

Federal law establishes the priority of **federal tax liens.** The Uniform Federal Lien Registration Act, adopted in Texas in 1989, states that, except for qualifying property tax liens and special assessment liens, the priority of a **federal income tax lien** is set by the date the lien is properly filed of record. Once recorded, the established priority continues for ten years. It can be timely renewed (refiled) every ten years without losing its initial priority.

Tax liens for **federal gift and estate taxes** are treated differently. These liens, sometimes called *silent liens,* attach at the deceased's death or at the date of a taxable gift. Filing is not required, but it is permitted. No assessment or demand is required. The lien attaches to all property included in the deceased's or donor's estate.

The lien is enforceable for ten years.

Holders of prior recorded security liens need not worry about losing priority to federal tax liens. A foreclosure on the prior recorded security interest will terminate a subordinate federal tax lien if the lienholder gives the district director of the Internal Revenue Service (IRS) at least 25 days advanced notice of the foreclosure. The notice must be sent by registered or certified mail or delivered personally. The requirements of the notice are found in 26 CFR Section 301.7425-3(d).

Giving proper prior notice of the sale does not cancel the IRS's interest. The IRS has 120 days from the date of the nonjudicial foreclosure sale to redeem the property by tendering the sales price. (See Internal Revenue Code [IRC] Section 7425[d].)

Likewise, taxpayers are given the right to redeem property following the foreclosure of a federal tax lien by the IRS. The redemption period lasts 180 days. The redemption price is the sales price plus 20 percent interest. (See IRC Section 6337.) A redemption, however, reconstitutes all junior liens on the property otherwise eliminated by the foreclosure sale.

State tax liens spring primarily from unpaid sales, excise, use, franchise and inheritance taxes. (Unemployment taxes are not discussed.) State tax liens attach to all property of the person liable for the tax (see Sections 113.0016 and (b) of the Texas Tax Code). However, to establish priority, state tax liens against real property must be filed in the county clerk's office in the county where the real property is located. A foreclosure of a prior secured lien terminates subordinate state tax liens.

State tax liens and federal tax liens differ in several ways. First, all state tax liens must be recorded to establish priority. There are no silent tax liens. Second, state tax liens attach only to the taxpayer's nonexempt property. Federal tax liens attach to homestead property. The IRS may sell a couple's homestead even when only one spouse is liable for the tax (*U.S. v. Rodgers,* 461 U.S. 677 [1983]). Third, no prior notice of a pending foreclosure on a superior security lien needs to be given to extinguish a state tax lien. And finally, the taxpayer is afforded no redemption period following a state tax lien foreclosure.

In general, state tax liens are enforceable for three years from the date of recording, the date the tax determination becomes final or the date a deficiency is due, whichever is later. However, the tax liens can be renewed by refiling every three years.

The state comptroller can seize and sell the taxpayer's nonexempt property in satisfaction of a lien by giving a 20-day prior notice. A taxpayer remains personally liable for unpaid state taxes even though the state tax lien expires. In the case of unpaid state inheritance taxes, the state may rely on the personal liability of anyone acquiring the property subject to the tax but only to the value of the property acquired. (See Texas Tax Code Section 211.108.)

Property tax liens attach to the taxable property on January 1 of each year. However, property taxes are not deemed delinquent until February 1. No filing of the lien is required.

Property tax liens differ from federal and state tax liens in several respects. First, the tax lien does not attach to all the taxpayer's property but only to the tract creating the delinquency. (See *Richey v. Moor,* 249 S.W. 172.) Second, the lien has automatic superiority to all prior security liens, federal tax liens and state tax liens without the prerequisite of filing. However, a foreclosure of the property tax lien without making a due effort to notify the prior lienholder may violate due process. (See *County of Burleson v. General Electric Capital Corp.,* 831 S.W. 2d 54.) Finally, the lien is enforceable for 20 years. No extension is permitted.

Property tax liens are superior to liens held by property owner associations (POAs) and homeowner associations for unpaid assessments, fines, dues and so forth. In most instances, these liens are extinguished by a tax foreclosure sale even when they arise prior to the tax lien. However, if the POA or homeowner's association records their liens in the deed records prior to the tax sale, the taxing authorities must join them in any foreclosure action. Their lien survives the tax sale when the taxing authorities fail to join them.

Property tax liens do not have exclusive priority. They are in-ferior to claims against the decedent's estate for survivor's allowances, funeral expenses or expenses of the decedent's last illness. Also the Fair Debt Collection Procedure Act of 1990 (28 USC Section 3001, *et seq.*) preempts state law as to abstracts of judgments held by the federal government or quasi-governmental agencies. Finally, special assessment liens, discussed later, are not superceded but maintain equal priorty with respect to the particular property in question. (See *Evans v. Whicker,* 90 S.W. 2d 554.)

A taxpayer remains personally liable for unpaid state taxes even though the state tax lien expires.

Purchasers should obtain tax certificates from the local tax collector to verify the absence of property tax liens. If the certificates erroneously fail to disclose any delinquencies or to include the property on the tax roll because of an omission, the tax lien is extinguished against the property, but the debt continues personally against the prior owner.

Taxpayers are allowed two years to redeem the property following a property tax lien foreclosure sale when the property is a homestead, agricultural land or mineral property. Otherwise the redemption period is six months. The redemptive price is basically 125 percent of the sales price the first year and 150 percent the second.

Assessments are charges levied against real property by state or local authorities to fund improvements benefiting the land. The improvements include roads, streets, highways, sewers and public utilities.

Assessment liens generally attach when the assessment is levied, but the rules vary. Assessment liens receive equal priority with property tax liens as discussed earlier, superceding all prior mortgage liens and all prior federal and state tax liens. Because an assessment is not a tax, assessment liens do not attach to homestead property.

Assessment liens are enforceable for four years when held by a private party. However, assessment liens held by the state, county, city or school districts never expire.

This article is based on an article written by Jerel J. Hill and used by permission. Hill is a board certified attorney in residential and commercial real estate law in Houston.

REAL ESTATE CENTER

MAYS BUSINESS SCHOOL

Texas A&M University
2115 TAMU
College Station, TX 77843-2115

http://recenter.tamu.edu
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