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October 19, 2005

TO: Clients and Friends

FROM: David F. Dulock and Diane Gleason

SUBJECT: Refinance of Ad Valorem Tax Liens on Texas Homestead Without Complying with Sections 32.06 and 32.065 of the Texas Tax Code – Update to August 15, 2005 Memorandum

This memorandum attempts to clarify our August 15, 2005 memorandum on this subject by addressing the issue of whether Sections 32.06 and 32.065 of the Texas Tax Code are the exclusive method for refinancing ad valorem tax debt on Texas homestead property. Please refer to this firm's August 15, 2005 memorandum located on our website at www.bmandg.com under the "what's new?" icon for a full discussion of the transfer and refinance of ad valorem tax liens pursuant to Sections 32.06 and 32.065, Texas Tax Code.

Prior to the 2005 legislative amendments to Sections 32.06 and 32.065, their use to refinance ad valorem tax debt assured lenders they had perfected a valid lien under the Tax Code and the Texas Constitution against a Texas homestead with little, if any, downside. However, the 2005 amendments now limit this method (with two exceptions) to delinquent taxes and place additional notification and documentation burdens on lenders and expand third-party redemption rights (*see 8-15-05 memo*). For this reason, it is now reasonable to inquire if there is an alternative method for perfecting a valid lien on a Texas homestead when financing the payment of ad valorem taxes. This memorandum explores that alternative method.

When the purpose (or one of the purposes) of a loan is to pay ad valorem taxes due on real property and secure it with a valid lien, Texas case law, while informative, is not as clear as one would like. The weight of authority, however, appears to be that compliance with Sections 32.06 and 32.065 is not the exclusive method for perfecting a lien in payment of ad valorem tax debt¹.

Section 15, Article VIII, of the Texas Constitution provides, in pertinent part, that “*The annual assessment made upon landed property shall be a special lien thereon.*” Section 50, Article XVI, of the Texas Constitution lists the only debts that may be validly secured by a Texas homestead, providing in subsection (a)(2) that the Texas homestead is not protected from forced sale for the payment of “*the taxes due thereon.*” These constitutional provisions provide the legal basis for the validity of tax liens on a Texas homestead. However, prior to the 1998 amendments to Section 50, there was no constitutional provision that expressly allowed a tax lien to secure a third party who, at the request of the homestead owner, voluntarily agrees to pay the taxes secured by the tax lien. The 1998 amendments to Section 50 added subsection 50(e) which reads, in pertinent part, “[a] *refinance of debt secured by a homestead ... that includes the advance of additional funds may not be secured by a valid lien against the homestead unless: ... the advance of all the additional funds is for ... a purpose described by Subsection (a)(2) ... of this section.*”

In addition, subsection 32.065(a) of the Texas Tax Code was amended in 2005 to read as follows: “*Section 32.06 does not abridge the right of an owner of real property to enter into a contract for the payment of taxes.*” Under Texas law a deed of trust constitutes a contract ².

Based on the above constitutional and statutory provisions, it is not unreasonable to conclude that a lender, at the request of the owner and without complying with Sections 32.06 and 32.065 of the Texas Tax Code, may refinance ad valorem taxes on homestead property, whether current or delinquent, by complying with subsections 50(e) and 32.065(a). That is, the loan must refinance a homestead debt and advance additional funds to pay ad valorem taxes due on the homestead pursuant to a deed of trust between the owner and lender that expressly evidences the contractual agreement for the payment of taxes. In our opinion this method is not as clear or certain under Texas statutory and case law as the method prescribed by Sections 32.06 and 32.065, which insures a lender that the transferred tax lien secures its loan³. However, in our opinion, the use of subsections 50(e) and 32.065(a) in the manner described in this paragraph provides a legally sufficient alternative to Sections 32.06 and 32.065, and the additional notice, documentation, and expanded redemption provisions of Sections 32.06 and 32.065 are avoided.

Our recommendation to clients who choose to use this alternative method is to close the loans only with title companies that will issue mortgagee title policies insuring lien validity without exception to coverage for failure to comply with the requirements of Sections 32.006 and 32.065 of the Texas Tax Code.

This memorandum is limited to refinancing homestead ad valorem tax debt under the authority of subsection 50(e). Because non-homestead property in Texas has no restrictions as to the types of debt it can secure, non-compliance with Sections 32.06 and 32.065 of the Texas Tax Code is not an issue for ad valorem tax refinance loans secured by non-homestead property.

Footnotes:

1. *Conroy Mortgage Corp. v. Fielder*, 375 S.W.2d 344 (Civ.App. – Fort Worth 1964, writ ref'd n.r.e.) (*deed of trust tax lien foreclosure overturned, mortgagee failed to obtain transfer of tax lien under Art. 7345a*); but see *Dotson v. Pahl*, 206 S.W.2d 272 (Civ.App. – Austin 1947, no writ) (*foreclosure of tax lien pursuant to suit to foreclose tax lien under mortgage and holding that Art. 7345a does not restrict private*

contracts with respect to payment of taxes and that party who pays taxes at the request of tax obligee is equitably subrogated to tax lien). **Trimble v. Farmer**, 305 S.W.2d 157 (Tex. 1957) (tax transferee did not get consent of all owners, no deed of trust involved). **McDermott v. Steck Co.**, 138 S.W.2d 1106 (Civ.App. – Austin 1940, writ ref'd) (owner requested bank to pay delinquent taxes and requested tax collector to transfer tax liens to bank; owner paid bank and had tax liens transferred to him; owner was equitably subrogated to tax lien even if bank did not acquire a lien pursuant to Art. 7345a). **Lewis v. Investors Savings Assoc.**, 411 S.W.2d 794 (Civ.App. – Fort Worth 1967, no writ) (deeds of trust secured by homestead executed for the purpose of paying taxes thereon held valid; opinion mentions but does not state whether Art. 7345a was complied with). **Note** - Above cases deal with Art. 7345a, the statutory predecessor to §32.06. See also **Texas Bank & Trust Co. v. Bankers' Life Co.**, 43 S.W.2d 631 (Civ.App. – Waco 1931, writ ref'd) (party who pays taxes pursuant to contract with owner is subrogated to tax lien superior to prior mortgage and consent of taxing unit to transfer of tax lien is not required); **First State Bank of Maypearl v. National Life Ins. Co.**, 51 S.W.2d 646 (Civ.App. – Waco 1932, no writ) (party who pays taxes pursuant to contract with owner is subrogated to tax lien superior to prior mortgage); and **Kauffmann v. Hahn**, 59 S.W.2d 435 (Civ.App. – San Antonio 1933, no writ) (party who pays taxes pursuant to contract with owner is subrogated to tax lien) - **note**, these cases occurred prior to the passage of Art. 7345a (the statutory predecessor to §32.06). **Smart v. Tower Land and Investment Company**, 597 S.W.2d 333 (Tex. 1980) (in what appears to be dicta, the court said "Whether one who pays property taxes assessed on property owned by another is entitled to subrogation to the taxing authority's lien, and if so, the extent to which he is subrogated, equitably or otherwise, to the special privileges accompanying the lien, has been the source of much litigation." Citing prior cases, the court stated, "The taxpayer's right to subrogation may arise by statute, or by express agreement. Furthermore, there is a statutory procedure whereby the taxing authority's lien may be transferred. See *Tex.Rev.Civ.Stat. Ann. art. 7345a (Vernon Supp. 1979)*. Even in the absence of statutory or contractual authorization, a limited right to equitable subrogation may arise in accordance with certain well-established rules of law.").

The above cited cases all occurred prior to the 1998 amendment adding subsection 50(e) to the Texas Constitution and the 2005 amendment to subsection 32.065(a), Texas Tax Code, discussed in this memorandum, and must now be viewed in light of these constitutional and statutory amendments.

2. *Smart v. Tower Land and Investment Company*, 597 S.W.2d 333 (Tex. 1980); §§51.0001 and 51.002, Texas Property Code.

3. §32.06(c), Texas Tax Code (as amended by Sec. 13 of House Bill 2491, 79th Legislative Session 2005).

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