HOMEOWNERS' RIGHTS: HOW COURTS CAN PREVENT STATES FROM STEALING HOME EQUITY DURING PROPERTY TAX FORECLOSURE

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Abstract

Governments can sell the property of someone who failed to pay their property taxes by conducting a property tax foreclosure. In most states, the harm is limited because governments only keep an amount equal to the taxes owed and have processes to return the rest, the surplus, to the property owner. However, several states keep all proceeds, even the amount beyond the taxes owed, for their own coffers. These states have surplus retention laws, which explicitly bar property owners from claiming the surplus they rightfully own. In this Note, I argue that surplus retention laws endorse government theft of privately owned property; property owners have an equity right in their property and states retaining the surplus violate the Takings Clause. The ramifications this has for homeowners cannot be understated.

This Note provides a roadmap for how property owners can attack state surplus retention laws in court. First, I outline the roadblocks property owners face in reaching federal courts and the legal arguments they can make to convince federal courts to hear their challenges to surplus retention laws. Then, I provide a brief history of challenges to surplus retention laws. I argue that property owners are most likely to succeed by bringing federal and state Takings claims against these laws. Finally, I distinguish between property rights in the surplus and the equity. Surplus is the difference between what the property is sold for and the taxes owed. Equity is the value of the property itself. I demonstrate how an equity right in the property, as opposed to a surplus right in the property, best protects property owners where governments are incentivized to sell or transfer properties at firesale prices. I conclude that courts should recognize property owners'

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equity right in the fair market value of their property, as anything less leaves property owners open to government theft of property equity.

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I. Introduction–Home Equity and Government Theft of Home Equity

For generations, American families built their wealth from homeownership.[1] Both empirically and in the American ethos, the home is often a household's most vital investment.[2] In 2015, the median net worth of a homeowner ($221,100) was over 80 times that of a renter

[1] ANA PATRICIA MUÑOZ ET AL., FED. RES. BANK OF BOS., THE COLOR OF WEALTH IN BOSTON 15 (2015) ("Homeownership serves as the primary asset in which most Americans build and store their wealth.").

[2] U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT OFFICE OF POLICY DEVELOPMENT & RESEARCH SENIOR LEADERSHIP, HOMEOWNERSHIP: THE AMERICAN DREAM (2018), https://www.huduser.gov/portal/ pdredge/pdr-edge-frm-asst-sec-081318.html ("For many Americans, owning a home is an essential part of the American dream that conveys a number of economic benefits, such as the ability to accumulate wealth and access credit by building home equity, reduce housing costs through the mortgage interest deduction, and gain long-term savings over the cost of renting.").

($2,759)—financial security is linked to homeownership.[3] Homeownership is also associated with secondary benefits; college graduation rates, health, and civic engagement all increase with homeownership.[4] However, homeownership's benefits are not equally distributed. In Boston, 79% of whites are homeowners, as opposed to 34% of blacks, and white households have a median net worth of $247,500, as opposed to black households with a median net worth of $8.[5] This stark dichotomy sparked a *Boston Globe* article titled, "That was no typo: The median net worth of black Bostonians really is $8".[6] Promoting and preserving homeownership, especially in low-income and non-white households, is central to correcting unequal distributions of wealth.

For these reasons, the federal government has, for decades, implemented programs to promote homeownership, especially among low-income households.[7] Congress passed the 2003 American Dream Downpayment Initiative to "reduce racial inequality" by assisting first-

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[3] U.S. CENSUS BUREAU, WEALTH AND ASSET OWNERSHIP FOR HOUSEHOLDS, BY TYPE OF ASSET AND SELECTED CHARACTERISTICS Table 1, (2019) (visualizing the necessary data).

[4] Michael F. Lovenheim & C. Lockwood Reynolds, *The Effect of Housing Wealth on College Choice: Evidence from the Housing Boom*, 48 J. HUM. RESOURCES 33 (2013) (linking housing wealth to increased college graduation rates); Stephanie Robert, *SES Differentials in Health by Age and Alternative Indicators of SES*, 8 J. AGING & HEALTH 384 (1996) (finding homeownership a predictor of functional health of older adults); Denis DiPasquale & Edward L. Glaeser, *Incentives and Social Capital: Are Homeowners Better Citizens?*, 45 J. URB. ECON. 383 (1999) (finding strong correlation between homeownership and civic involvement, likely due to homeownership allowing for longer community tenure).

[5] MUÑOZ ET AL., *supra* note 1, at 15, 20.

[6] Akilah Johnson, *That Was No Typo: The Median Net Worth of Black Bostonians Really is $8,* BOSTON GLOBE (Dec. 11, 2017, 4:24 PM). (quoting the title).

[7] Rachel Bogardus Drew, *Constructing Homeownership Policy: Social Constructions and the Design of the Low-Income Homeownership Policy Objective*, 28 HOUSING STUD. 616, 617 (2013) ("The U.S. federal government has a long history of promoting homeownership through public policy ... While the policy actions taken in support of increasing homeownership from the 1990s onward served a wide range of households, low-income households were arguably the primary target and largest beneficiary of these policies ... Aided by innovations within the mortgage industry, low interest rates, and a strong economy, this set of policy actions, reactions, and non-actions … greatly increased low-income households' access to home mortgage borrowing and home-buying opportunities.").

time homebuyers' down payments.[8] With federal initiatives promoting homeownership, especially as a tool to reduce racial inequality, one might expect state policy to also reflect a commitment to promoting homeownership. Instead, several states have laws where, when a property owner is delinquent on their taxes and the state auctions off the home to recoup the taxes owed, the state keeps the sale's proceeds *beyond* the taxes owed.[9]

Eight states have such laws, and when the state takes more than the taxes it was owed, the state is engaging in government theft of home equity under the guise of tax collection.[10] If a property owner is late on their property taxes, state governments are well within their authority to recoup the taxes through a tax foreclosure sale.[11] But when properties sell for *more* than the taxes owed, governments in these eight states keep the profits; they don't give the right to the profits to the property owners.[12] These laws, which I call "surplus retention laws," specifically exclude property owners from the distribution of profits, also known as surplus proceeds. Property owners facing tax foreclosure sales likely failed to make their tax payments due to short-term financial stress or lack of adequate notice of the impending sale, and while governments

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[8] Laurie S. Goodman & Christopher Mayer, *Homeownership and the American Dream*, 32 J. OF ECON. PERSPECTIVES. 31 (2018) ("President George W. Bush framed homeownership as a way to reduce racial inequality, and in 2003 signed the American Dream Downpayment Initiative to assist first-time homebuyers with obtaining a down payment").

[9] See statutes cited *infra* note 10.

[10] *See e.g.,* ALA. CODE § 40-10-28 (2021); ARIZ. REV. STAT. ANN. § 42-18267; 35 ILL. COMP. STAT. ANN. 200/21-350, 200/21-370 (West 2021); IND. CODE ANN. §§ 6-1.1-24-6.1, 6-1.1-25-4 (West 2021); MINN. STAT. ANN. §§ 281.02, 17 (West 2021); MISS. CODE. ANN. § 27-45-3 (West 2021); MONT. CODE ANN. § 15-17-322 (West 2021); OR. REV. STAT. ANN. § 312.120 (West 2021).

[11] JOHN RAO, NAT'L CONSUMER L. CTR., THE OTHER FORECLOSURE CRISIS: PROPERTY TAX LIEN SALES 8 (2012) ("All states have laws that permit local governments to sell property through a tax lien foreclosure process if the owner fails to pay the property taxes.").

[12] Jenna Christine Foos, *State Theft in Real Property Tax Foreclosure Procedures*, 54 REAL PROP. TR. & EST. L.J. 101–02 (2019) ("In a surplus retention system, the foreclosing government entity is required to do something with the foreclosure sale surplus other than return it to the original owner. Usually, the government claims free and clear title to the delinquent property before the foreclosure sale, sells the delinquent property, pays the taxes and fees out of the sale price, and retains the entire surplus for governmental use.").

do have rightful claims to delinquent taxes, when they keep the profits, they unnecessarily destroy home equity.[13]

Eight states have surplus retention laws that endorse governments retaining (or stealing) surplus proceeds in tax foreclosure sales.[14] There are two types of these laws. The first has a "redemption period" after the sale—if the former owner pays, within the outlined period, all previous delinquent taxes and fees, interest, and, sometimes, what the property was sold for during foreclosure, the property is returned to the owner.[15] The second type is the most draconian—these laws do not provide a redemption period, so after the sale, there is no grace period during which the owners can attempt to buy back their property.[16]

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[13] *Id.* at 95 ("[T]he government's refusal to return the surplus from the foreclosure sale can result in huge losses of home equity.").

[14] *See* statutes cited *supra* note 10.

[15] ALA. CODE § 40-10-28 (2021) (providing redemption period of three years during which the county retains the excess in a county treasury account while also retaining interest on that excess); *Id.* §§ 40-10-193, -121, -122 (requiring payment of all taxes, interest, penalties, fees, purchase cost of the home and eight percent interest on both the purchase cost of the home and any excess bid up to 15 percent of the home's market value); IND. CODE ANN. §§ 6-1.1-25-4, 6-1.1-24-6.1 (West 2021) (providing redemption period of one year after sale or 120 days after sale to qualified purchasing agency and requiring payment of minimum bid, ten percent of selling price, attorney's fees and costs of giving notice, costs of title search, taxes and assessments paid by purchaser of home with an added interest rate of ten percent, and all costs to county to sale); 35 ILL. COMP. STAT. ANN. 200/21-350, 200/21-370 (West 2021) (providing redemption period of two years and requiring payment of all taxes, costs, interest, and a penalty interest of twelve percent for how long taxes were delinquent); OR. REV. STAT. ANN. § 312.120 (West 2021) (providing redemption period of two years and requiring payment of all delinquent taxes and taxes after the property was sold, interest on those taxes, a five percent penalty on the total amount, and $50 or the title search fee); MINN. STAT. ANN. §§ 281.17, .02 (West 2021) (providing redemption period of three years and requiring payment of bid in cost for government to purchase, all delinquent taxes prior to and after sale, penalties, costs, and interest); MISS. CODE. ANN. § 27-45-3 (West 2021) (providing redemption period of two years after day of sale and requiring payment of all delinquent taxes, a five percent penalty on delinquent taxes, costs to sale, all taxes since sale, and interest rate of 1.5 percent per month for both taxes and costs).

[16] ARIZ. REV. STAT. ANN. § 42-18267 (providing that the owner's failure to redeem before the deed is delivered to the state terminates any redemption rights); MICH. COMP. LAWS ANN. § 211.78k(5) and (6) (West 2021) (providing

Instead of stealing surplus proceeds, governments should distribute the proceeds through the following steps: Once the tax foreclosure sale pays off all delinquent taxes (and any reasonable fees or costs), the property owner receives the rest—the surplus. The surplus proceeds enter the property owner's account, not the foreclosing government entity's account. Governments only receive the amount of taxes owed and nothing more. As a default, property owners will always receive the surplus, and if the state has a redemption period, the property owner also has the option of buying back the property. This proposed system is not new. It may even follow what one instinctually expects to already be the case, because this is how the private market distributes surplus proceeds from foreclosure sales.

In the private real estate market, when there is a surplus after proceeds from a mortgage foreclosure sale are paid to lienholders, the property owner keeps the surplus.[17] In the model law of secured transactions, the UCC provides that a secured party must "account to and pay a debtor for any surplus" that is leftover after the sale of collateral pays the secured party for the amount in which they were secured.[18] In both commercial and personal property foreclosure sales, the lender receives only what they are owed and the borrower receives the surplus.

Both Democratic and Republican economic platforms can support the axiom that governments should match an equity baseline set by the private market.[19] This makes the survival of state laws promoting

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the redemption period ends on the March 31 after the judgment of foreclosure, the date when fee simple title of the property vests absolutely in the foreclosing governmental entity); MONT. CODE ANN. § 15-17-322 (West 2021) (not providing a right to redeem and stating any surplus funds are deposited to the county's general fund).

[17] 59A FRANCIS C. AMENDOLA, ET AL., CORPUS JURIS SECUNDUM § 1322 (2021) ("The surplus proceeds of a foreclosure sale, after satisfying the mortgage debt, represent the equity of redemption and generally belong to the mortgagor even if the mortgagor has been discharged in bankruptcy …"; 2 ALVIN L. ARNOLD & MYRON KOVE, CONSTR. & DEV. FIN. § 6:36 (2021). ("Most state statutes provide that if a foreclosure sale produces excess proceeds, the same is distributed to the mortgagor unless there are junior lienors.").

[18] U.C.C. §9-615(d).

[19] Molly Ball, *The Privatization Backlash,* THE ATLANTIC, https://www.theatlantic.com/politics/archive/2014/04/city -state-governments-privatization-contracting-backlash/361016/ ("Most of the privatization skeptics are Democrats, who tend to be sympathetic to the labor unions fighting to save public-sector jobs."); John B. Goodman & Gary W. Loveman, *Does*

government surplus retention even more mystifying. If political forces are not to blame for the endurance of surplus retention laws, then perhaps it is a lack of knowledge that these laws even exist, because they run so contrary to public expectation. However, there could be a more cynical reason—if governments can keep profits from sales and reap monetary benefits, what incentivizes state legislators to rewrite these laws? Absent widespread state-level education and community lobbying of state legislators, lawmakers do not have the correct incentives to amend these laws. While this Note sheds light on the existence of surplus retention laws and urges state legislators to remove them, property owners have another venue for recourse—the courts.

This Note provides a roadmap for property owner plaintiffs to invalidate these eight states' surplus retention laws in court. Section II highlights roadblocks to bringing these cases into federal court. Most pressing is the Tax Injunction Act (TIA), which bars federal courts from hearing cases that restrain state tax collection efforts. If a court defines surplus retention as a tax, then the TIA bars any federal court from hearing a constitutional challenge to surplus retention laws. There is a circuit split in the definition of "the collection of any tax" in the TIA, but it is clear that surplus retention cannot be construed as a tax under either definition. Section III outlines the state and federal claims plaintiffs can make. I provide a brief case history of challenges to surplus retention laws. In Section IV, I outline property owner plaintiffs' best argument for invalidating surplus retention laws—state and federal takings claims. This argument relies heavily on *Rafaeli, LLC v. Oakland County*, a recent Michigan Supreme Court decision finding Michigan's surplus retention law unconstitutional per Michigan's Takings Clause. In Section V, I discuss how federal and state courts can and should go beyond returning to property owners the *surplus* proceeds—they should compensate for the *equity*. If a property owner can only keep the *surplus*, if the property sells for exactly the amount of taxes owed, they are left with nothing. If the property owner is compensated for their *equity*, the government is incentivized to ensure the sale matches the fair market

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Privatization Serve the Public Interest, HARVARD BUSINESS REVIEW, https://hbr.org/1991/11/does-privatization-serve-the-public-interest (describing the Reagan administration view of privatization, that "the profit-seeking behavior of new, private sector managers will undoubtedly lead to cost cutting and greater attention to customer satisfaction" as well as bringing "a panoply of significant improvements: boosting the efficiency and quality of remaining government activities, reducing taxes, and shrinking the size of government ...").

value of the property's value, and even if the sale does not, the property owner is compensated for the equity the government took by selling their property.

II. Reaching Federal Courts

If the property owner plaintiffs clear the TIA and comity hurdles, they can challenge the constitutionality of state surplus retention laws in federal courts (which have federal question jurisdiction and supplemental jurisdiction over analogous state constitutional claims).[20] If property owner plaintiffs can't clear the TIA or comity hurdles, state courts have general jurisdiction and can still hear these challenges, which I discuss in Section IV.[21] Additionally, a recent ruling from the Supreme Court has made it clear that "[a] property owner may bring a takings claim under § 1983 upon the taking of his property without just compensation by a local government" to federal court, overturning a previous requirement to litigate at the state court level first.[22]

I begin with the issue of reaching federal courts because plaintiffs often perceive local courts as biased towards protecting local officials or governments.[23] Because plaintiffs will typically sue either the foreclosing government entities, such as state counties, or the state officials themselves, federal court jurisdiction is important.[24] Property owners seeking to invalidate surplus retention laws in federal courts must first show the courts have jurisdiction over their claims. Furthermore, these plaintiffs will likely allege violations of the Fifth Amendment Takings Clause (through the Fourteenth Amendment) in tandem with violations of the analogous state constitution Takings

[20] 28 U.S.C. 1331-1367 (2021).
[21] Tafflin v. Levitt, 493 U.S. 455, 458 (1990) ("[T]he States possess sovereignty concurrent with that of the Federal Government, subject only to limitations imposed by the Supremacy Clause. Under this system of dual sovereignty, we have consistently held that state courts have inherent authority, and are thus presumptively competent, to adjudicate claims arising under the laws of the United States.").
[22] Knick v. Twp. of Scott, 139 S. Ct. 2162, 2179 (2019).
[23] *See* Victor E. Flango, *Litigant Choice between State and Federal Courts*, 46 S. C. L. REV. 961, 964 (1995) (discussing how plaintiffs prefer federal courts because they perceive state courts to discriminate against out-of-state citizens).
[24] *See* Freed v. Thomas, 976 F.3d 729, (6th Cir. 2020); Automatic Art v. Maricopa, No. CV 08-1484-PHX-SRB, 2010 WL 11515708, (D. Ariz. Mar. 18, 2010).

Clause, so they may also prefer federal courts for their constitutional expertise.[25]

A. The Tax Injunction Act (TIA)

The TIA provides that "[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."[26] Due to the TIA, some federal courts have claimed they lack jurisdiction to hear surplus retention challenges, stonewalling plaintiffs from entering federal courts.[27] While the text on its face seems to only bar injunctions, the Supreme Court in *Hibbs v. Winn* interpreted the TIA broadly to shield "state tax collections from federal-court restraints," so federal courts cannot hear suits seeking to "stop the collection (or contest the validity) of a tax *imposed on plaintiffs*."[28] Therefore, plaintiffs can't bring surplus retention challenges to federal court if the court considers surplus retention as tax collection or a tax.

The Supreme Court has defined "collection" in the TIA to be "the act of obtaining payment of taxes due."[29] Surplus, definitionally, is never part of the delinquent "taxes due," because surplus is "in excess

[25] Flango, *supra* note 23, at 971 ("Concern about the quality of justice in state courts might be another aspect of the concern over local bias.").
[26] 28 U.S.C. § 1341 (2018).
[27] *See* Clark v. Mobile, No. 06-0155-CG-C, 2007 WL 9717529, at *4 (S.D. Ala. Nov. 8, 2007) (finding a lawsuit challenging Alabama's surplus retention law barred by the TIA because "the flow of ad valorem tax revenue would be reduced should the plaintiff's lawsuit succeed.").
[28] Hibbs v. Winn, 542 U.S. 88, 104 (2004); *see also Hibbs* at 108 ("In sum, this Court has interpreted and applied the TIA only in cases Congress wrote the Act to address, i.e., cases in which state taxpayers seek federal-court orders enabling them to avoid paying state taxes."); Great Lakes Dredge & Dock Co. v. Huffman, 319 U.S. 293, 299 (1943) (finding the TIA also bars declaratory judgments challenging a state tax law's constitutionality); Coleman through Bunn v. D.C., 70 F. Supp. 3d 58, 67 (D.D.C. 2014) ("The Act has been interpreted to bar not only injunctions, but also actions seeking declaratory judgments regarding the validity of tax collection.").
[29] Direct Mktg. Ass'n v. Brohl, 575 U.S. 1, 10 (2015).

of what is owed."[30] Retaining surplus is obtaining payment beyond the amount of taxes due and beyond the reach of the TIA.[31]

The circuits are split over the definition of "the collection of any tax" within the meaning of the TIA.[32] Still, surplus retention is not a tax under either definition. The circuit split arises over whether penalties contribute to "obtaining payment of taxes due."[33] Judge Posner distinguishes taxes as distinct from penalties and fees; taxes generate revenues for government agencies while penalties are designed to punish, and fees are designed to compensate for the price of a government service.[34] Therefore, the TIA does not bar federal jurisdiction from hearing an attack against a state penalty, because a penalty is distinct from a tax.[35] The Seventh Circuit has used this reasoning to find that penalties, such as those that serve to incentivize debtors to pay their legal obligations, do not fall within the TIA.[36] But distinguishing between penalties and taxes by their purpose—as punitive or simply revenue-creating—is difficult when both penalties and taxes generate revenue.[37] This vague

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[30] Rafaeli, LLC v. Oakland Cnty., 952 N.W.2d 434, 464 (Mich. 2020).

[31] *Id.* at 480 (stating that the tax authority's "retention of the surplus proceeds amounts to a taking of plaintiffs' properties far in excess of plaintiffs' tax debts that cannot be justified as a valid form of tax collection").

[32] *See infra* note 38 and accompanying text.

[33] *See infra* note 38 and accompanying text.

[34] Empress Casino Joliet Corp. v. Balmoral Racing Club, Inc., 651 F.3d 722, 728 (7th Cir. 2011) ("The only material distinction is between exactions designed to generate revenue—taxes ... —and exactions designed either to punish (fines, in a broad sense) rather than to generate revenue … or to compensate for a service that the state provides to the persons ... in other words, a fee."); Diginet, Inc. v. W. Union ATS, Inc., 958 F.2d 1388, 1399 (7th Cir. 1992) ("If [the "fee"] is calculated not just to recover a cost imposed on the municipality or its residents but to generate revenues that the municipality can use to offset unrelated costs or confer unrelated benefits, it is a tax, whatever its nominal designation.").

[35] *See supra* note 34 and accompanying text.

[36] RTC Commercial Assets Trust v. Phoenix Bond & Indem. Co., 169 F.3d 448, 457 (7th Cir. 1999) ("States do not assess penalties for the purpose of raising revenue; they assess them so that delinquent tax debtors will be deterred the next time around from ignoring their legal obligations. In a Utopian world where all citizens complied fully with their obligations, no penalties at all would be collected. This suggests that the penalty is ... a special purpose regulatory device.").

[37] Brett J. Wierenga, *The Label Test: Simplifying the Tax Injunction Act after NFIB v Sebelius*, 84 U. CHI. L. REV 2103, 2114 ("distinguishing taxes from

distinction between penalty and tax has created a "clear circuit split" between the Seventh Circuit and the Fifth and Ninth Circuits regarding tax delinquency penalties.[38]

The Fifth Circuit treats penalties as part of the tax because penalties serve to "defray the costs of collection" and the TIA covers "the broader activities of assessing, levying, and collecting taxes."[39] Therefore, penalties are "inexorably tied to the tax collection itself."[40] The Ninth Circuit similarly treats penalties on delinquent taxes as taxes and has found that the TIA bars challenges to state laws regarding penalties.[41]

Under the Seventh Circuit's definition, surplus retention challenges are not barred by the TIA because surplus is in excess of the taxes owed and definitionally not a tax. Even under the Fifth and Ninth Circuit's broader definition, these challenges are not barred because surplus retention can't be a penalty or a tax—surplus retention is independent of the tax, occurring *after* all taxes due are already obtained. The TIA, regardless of the definitional split, does not bar surplus retention challenges because surplus retention is neither a tax nor a penalty.

Per the Supreme Court's definition, surplus retention has nothing to do with "obtaining payment of taxes due" since surplus retention occurs only after payment of taxes due.[42] However, courts continue to get this wrong.

The Southern District of Alabama in *Clark v. Mobile* found the TIA barred the Court from hearing a challenge to Alabama's surplus retention law because the challenge would allow the plaintiff to avoid

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penalties is more difficult, as both raise revenue beyond any costs imposed on the government.").

[38] *Id.* at 2117, 2119 ("Tax Delinquency Penalties Present a Clear Circuit Split ... The Seventh Circuit holds that tax delinquency penalties are not taxes, and therefore not subject to the TIA, while the Fifth and Ninth Circuits hold that they are.").

[39] Washington v. Linebarger, 338 F.3d 442, 443–45 (5th Cir. 2003) (finding that plaintiffs "challenging the constitutionality of a 1998 City of New Orleans ordinance authorizing the collection of delinquent ad valorem taxes through private parties and assessing an additional thirty percent penalty for collection costs" were required, by the Tax Injunction Act, to "first challenge the New Orleans ordinance in Louisiana courts").

[40] *Id.* at 444.

[41] Huang v. City of Los Angeles, 637 F. App'x 363, 364 (9th Cir. 2016) ("[T]he business taxes assessed by the City of Los Angeles, as well as the penalties added thereto for delinquent payment, are 'taxes' under the TIA.").

[42] Direct Mktg. Ass'n v. Brohl, 575 U.S. 1, 10 (2015).

paying his taxes.[43] The Court described surplus retention as "an incentive for landowners to settle their debts before their land is sold."[44] The Court commits two fatal errors—(1) characterizing surplus as a tax when surplus is definitionally in excess of tax and (2) describing surplus retention as a penalty that incentivizes tax collection, when surplus retention can only be paid *after* all taxes due are paid. In *Clark*, the plaintiff's property was sold for $9,864.04 in excess of what was owed, and the Court itself describes the surplus as "in excess of the amount he owed in taxes."[45] However, the Court then defines the surplus as part of tax collection, stating that prohibiting the acceptance of excess funds would "restrain the collection of ad valorem taxes in violation of TIA."[46] That surplus, the "excess of the amount owed in taxes" can somehow also be part of the tax defies common sense.[47] Even more bewildering is describing surplus retention as an incentive to tax payment when surplus retention can only occur after all taxes are paid. The Court incorrectly applies *Hibbs*, which bars federal courts from allowing taxpayers to avoid paying state taxes.[48] Here, the plaintiff can't be seeking to avoid paying his taxes if all taxes owed were paid; surplus retention is definitionally beyond the tax owed.[49]

I belabor this point on the TIA, even though I believe it is clear that surplus retention is not a tax or a penalty to be considered a tax, because government defendants will use the TIA early on as a reason to get a case dismissed.[50] Other courts support my reasoning that surplus retention is not a tax. The District Court of Minnesota in *Tyler v. Hennepin County* found the TIA did not bar it from hearing a case challenging Minnesota's surplus retention statute because "the County's retention of the surplus equity" was not part of the collection of any tax,

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[43] Clark v. Mobile, No. 06-0155-CG-C, 2007 WL 9717529, at *4 (S.D. Ala. Nov. 8, 2007) ("Such challenges necessarily restrain the collection of ad valorem taxes in violation of TIA.").
[44] *Id.*
[45] *Id.* at *1.
[46] *Id.* at *4.
[47] *Id.* at *3 ("This characteristic, the plaintiff suggests, deprives the excess funds 'of the certainty and definiteness' of a tax.").
[48] *Id.* at *4 (quoting *Hibbs* to characterize the plaintiff's challenge to the law as allowing him to avoid paying state taxes).
[49] *Id.* at *1 ("When the plaintiff redeemed his property, in September 2003, he was required to pay his back taxes, interest at 12% on those taxes, and interest at 12% on the excess funds.").
[50] *Id.* at *2 ("The Tax Injunction Act ("TIA"), when it applies, deprives a federal court of subject matter jurisdiction.").

and "the County's retention of the surplus equity [occurred] *after* the County had collected every penny ... "[51] The Sixth Circuit in *Freed* also found the TIA did not bar it from hearing a challenge on Michigan's surplus retention statute because the Court described surplus retention as a "post-collection failure to reimburse [] for the excess proceeds."[52] If surplus were part of the tax, it would be part of the amount of tax owed, not the surplus.[53] And surplus cannot be part of tax collection if it is a post-collection taking.

Even if the property owner plaintiff clears the TIA hurdle, they must then contend with a principle that rears its head with the TIA—comity. A note on the TIA's history—Congress passed the TIA in 1937 to protect state taxation regimes from large foreign corporations who sought federal courts (through diversity jurisdiction) where, for the duration of the litigation, they could delay paying their state tax bill, effectively avoiding their state tax bill.[54] However, the Supreme Court has since extrapolated away from this Congressional purpose to find the TIA not only "shield[s] state tax collections from federal-court restraints", as discussed earlier, but also incorporates the principle of comity.[55]

B. Comity

Federal courts' reluctance to interfere with state tax collection regimes stems from the over one century old comity doctrine, a federalism concern to protect state independence and the tool "that the several States chiefly rely to obtain the means to carry on their respective governments."[56] The Supreme Court in *Dows v. City of Chicago* refused to hear a case challenging the constitutionality of a

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[51] Tyler v. Hennepin Cty., 505 F. Supp. 3d 879, 887 (D. Minn. Dec. 4, 2020).
[52] Freed v. Thomas, 976 F.3d 729, 734 (6th Cir. 2020).
[53] *Id.* at 736 ("Thus, any funds in excess of Freed's $1,100 tax debt—the only funds at issue in this lawsuit—represent surplus property, not tax proceeds.").
[54] Wierenga, *supra* note 37, at 2107 ("According to the conference report accompanying the bill, the Senate Committee on the Judiciary was most concerned with stabilizing state and local government finances, especially in protracted diversity cases involving large foreign corporations.").
[55] Hibbs v. Winn, 542 U.S. 88, 104 (2004); Wierenga, *supra* note 37, at 2107 ("The Court stressed that 'the principle of comity [ ] underlies [the TIA].'" (quoting Franchise Tax Bd. of California v. Alcan Aluminium Ltd, 493 US 331, 333 (1990))).
[56] Dows v. City of Chicago, 78 U.S. 108, 110 (1870).

state's tax law for this purpose.[57] This principle continued to be "frequently followed" and "never doubted."[58] After Congress passed the TIA in 1937, the Supreme Court continued to prefer for state courts to handle constitutional challenges to state taxation regimes rather than deciding the validity itself.[59] More recently, in 1981 the Supreme Court found that "taxpayers are barred by the principle of comity from asserting § 1983 actions against the validity of state tax systems in federal courts."[60]

However, if the federal court adopts a favorable TIA ruling for the plaintiffs, then it is likely the comity question is similarly dismissed.[61] For example, in *Freed*, after the court described the TIA as irrelevant due to surplus retention not being part of tax collection, the court summarily dismissed the comity bar "because, as previously discussed, Freed does not challenge Michigan's taxing authority or the validity of Michigan's tax system."[62] If the court finds surplus retention is not a tax, then it is unlikely comity bars a federal court from hearing a constitutional challenge to a non-tax state law.

On the flip side, if the federal court finds the TIA bars the court from hearing a surplus retention challenge, then it is likely it will also find comity has the same effect. In *Clark*, after the court found the TIA barred the challenge, they also found that "[a]ny attempt, including this one, to declare a tax sale illegal or to recover damages on the ground of illegality is barred by the comity doctrine."[63] If the court defines surplus retention as a tax, then it will likely dismiss the case for TIA and comity reasons, but if the court correctly defines surplus retention as a post-tax collection, then it should not dismiss the case for TIA and comity reasons.

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[57] *Id.*

[58] Boise Artesian Hot & Cold Water Co. v. Boise City, 213 U.S. 276, 283 (1909).

[59] Great Lakes Dredge & Dock Co. v. Huffman, 319 U.S. 293, 297 (1943) (deciding not to rule on a challenge of a state tax law's constitutionality on comity grounds); *See also* Fair Assessment in Real Est. Ass'n v. McNary, 454 U.S. 100, 100 (1981) (discussing how *Great Lakes* demonstrates that comity was alive and well after the TIA).

[60] Fair Assessment in Real Estate Ass'n v. McNary, 454 U.S. at 116.

[61] Freed v. Thomas, 976 F.3d 729, 732 (6th Cir. 2020). ("We hold only that neither the Tax Injunction Act ("TIA") nor the related doctrine of comity forestall Freed's suit from proceeding in federal court.").

[62] *Freed*, 976 F.3d at 734.

[63] Clark v. Mobile, No. 06-0155-CG-C, 2007 WL 9717529, at *6.

III. A Brief History of Surplus Retention Challenges

Before diving into the various claims plaintiffs might bring and evaluating their potential for success, a look into past surplus retention challenges will contextualize the later discussion.

A. *Nelson v. City of New York* Found Surplus Retention Laws Constitutional Where Adequate Notice Was Provided and Property Owners Had an Avenue to Claim the Surplus Proceeds

The Supreme Court case *Nelson v. City of New York* is the preeminent federal case on government surplus retention after (1) adequate notice and (2) the expiration of a period during which property owners can claim the surplus.[64] The Court found New York could retain surplus proceeds after the claiming period ended because the state gave adequate notice of the foreclosure and a procedure to claim the proceeds.[65] The Supreme Court ruled against the property owners' procedural due process, equal protection, and substantive due process claims, and, as will be discussed in Section IV, these claims against surplus retention laws are still weak today. While the Supreme Court dismissed the plaintiffs' federal Takings Clause claim, the Court has expanded takings doctrine since 1956, so a Takings Clause-based challenge today is not precluded by *Nelson*.[66]

Two property owners' properties were in dispute—the first had four-year-old unpaid water fees totaling $65 and the second had four-year-old unpaid water fees totaling $814.50.[67] The first property was assessed at $6,000, and after New York City foreclosed and acquired title to the property, it sold for $7,000.[68] The second property was assessed at $46,000, and after New York City acquired title to the property, the city retained the property instead of selling it, so the owner had no surplus proceeds to request.[69]

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[64] Nelson v. City of New York, 352 U.S. 103, 110 (1956) ("We hold that nothing in the Federal Constitution prevents this where the record shows adequate steps were taken to notify the owners of the charges due and the foreclosure proceedings.").
[65] *Id.*
[66] *See* discussion *infra* Section IV.
[67] *Nelson*, 352 U.S. at 105, 106.
[68] *Id.* at 105.
[69] *Id.* at 106.

The property owners first alleged a lack of procedural due process.[70] They were not aware that their bookkeeper failed to pay the water bill for over four years.[71] When the city mailed notice of the foreclosure proceedings to their properties' addresses, the bookkeeper hid these notices.[72] New York law provided that property owners could claim the surplus proceeds if they contacted the City within seven weeks, but when the property owners finally discovered the failed payments and the foreclosure proceedings, the seven-week statutory period had long passed.[73] They made an offer to pay all the delinquent water bill fees, interest, and penalties to keep their properties, but the City rejected the offer.[74]

While the plaintiffs did not receive actual notice, the Court found no deprivation of procedural due process because the "statutory notice requirements were satisfied" and the property owners took no action during the seven-week period to claim the proceed.[75] Furthermore, requiring actual notice would burden foreclosing government entities, like New York City that oversaw 834,000 tax parcels, and unfairly hold governments accountable for third-party misconduct.[76]

Then, the plaintiffs alleged a denial of equal protection, but that claim was even more fruitless.[77] While the property owners believed the

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[70] *Id.* at 104 ("Appellants challenge as violative of the Fourteenth Amendment the application of Title D, Chapter 17, of the New York City Administrative Code to two improved parcels of land owned by them as trustees.").
[71] *Id.* at 107. ("The reason they assign is that the mailed notices were concealed by their trusted bookkeeper, who is also alleged to have concealed from them the nonpayment of the water charges.").
[72] *Id.*
[73] *Id.* at 105, 106. ("However, appellants took no action during the 7 weeks allowed for redeeming the property through payment of back charges nor during the 20 additional days allowed for answering the City's complaint. Judgments of foreclosure were entered by default, and on August 22 the City acquired title to the parcel.").
[74] *Id.* at 106. ("The offer was refused, and the appellants instituted a plenary action to set aside the City's deed to the Powell Street property and to recover the surplus proceeds from the sale of the 45th Avenue property.").
[75] *Id.*
[76] *Id.* at 108 ("The affidavit of the assistant corporation counsel here states that there are more than 834,000 tax parcels in the City, and on the facts of this case the City cannot be held to a duty to determine why a taxpayer neglects some taxes while paying others.").
[77] *Id.* at 109 ("Appellants also claim a denial of the equal protection of the laws in that the City officials had available to them other remedies for collecting taxes.").

foreclosure on their properties was arbitrary because the City could have collected the delinquent taxes by accepting their offer, the Court found no discrimination since New York's statute explicitly states that properties can be foreclosed when taxes have been delinquent for four years.[78]

Next, the plaintiffs alleged a denial of substantive due process, specifically that they were "deprived of property without due process of law."[79] However, the Court explained New York's statute did not "absolutely preclude[] an owner from obtaining the surplus proceeds of a judicial sale" and if the property owners had claimed within the statutorily provided seven weeks, they could have kept the surplus.[80] Therefore, substantive due process is not denied as long as the foreclosing government entity provides adequate notice and a claiming period.[81]

The Court briefly addresses the plaintiff's claim of "a taking without just compensation."[82] This discussion was wrapped into the previously discussed substantive due process claim. Because today's takings doctrine derives from post-1956 Court decisions, the outcome in *Nelson* is not dispositive for a current challenge to a surplus retention law based on a federal takings claim.[83]

Lastly, perhaps with an eye towards comity, the Court conceded "that this is a harsh statute" but noted that "relief from the hardship imposed by a state statute is the responsibility of the state legislature and not of the courts."[84] This presaged later federal courts' reluctance to find state surplus retention laws unconstitutional.[85]

Nelson's holding still stands today—as long as a state statute provides adequate notice of foreclosure proceedings and a period during which the property owner can claim the surplus, the state can keep the

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[78] *Id.* ("What the City of New York has done is to foreclose real property for charges four years delinquent and, in the absence of timely action to redeem or to recovery any surplus, retain the property or the entire proceeds of its sale.").
[79] *Id.*
[80] *Id.* at 110.
[81] *Id.* ("We hold that nothing in the Federal Constitution prevents this where the record shows adequate steps were taken to notify the owners of the charges due and the foreclosure proceedings.").
[82] *Id.* at 109.
[83] *See* Knick v. Twp. of Scott, 139 S. Ct. 2162, 2178 (2019) (summarizing decades of development of the takings doctrine).
[84] *Nelson*, 352 U.S. at 110–111.
[85] *See* Reinmiller v. Marion Cnty., No. CV. 05-1926-PK, 2006 WL 2987707, at *3 (D. Or. Oct. 16, 2006) ("Federal courts have not been willing to disturb state tax laws and find constitutional violations.").

surplus after the period expires. *Nelson* precludes any procedural due process, equal protection, or substantive due process claims against similar surplus retention laws. However, the surplus retention law in *Nelson* is markedly different from the surplus retention laws I have described because it gave property owners a time period during which they could claim the surplus proceeds. In other words, for some period of time, property owners had a *right* to the surplus. The eight states with surplus retention laws I have described explicitly exclude property owners from this right, precluding them from *ever* being able to claim surplus proceeds. Yet recent challenges have misapplied *Nelson* to preclude claims against these different surplus retention laws.

B. Recent Challenges Have Incorrectly Applied Nelson, Rejecting Challenges to Surplus Retention Laws That Do Not Provide Property Owners an Avenue to Claim Surplus Proceeds

In *Reinmiller v. Marion County, Oregon*, Oregon's District Court rejected a challenge to its surplus retention law. When Reinmiller's property was sold, he owed the County $14,216.91 in taxes and fees.[86] The property sold for $167,000—a difference of $152,783.09.[87] Oregon's surplus retention statute provided a redemption period during which Reinmiller could buy back his property "by paying property tax arrearage, additional interim tax assessments, a 5% foreclosure proceedings penalty, and other costs."[88] However, Oregon, unlike New York in *Nelson*, does not provide property owners a right to claim the surplus proceeds.[89]

When evaluating Reinmiller's Fifth Amendment takings claim, the Court cited to *Nelson*, interpreting *Nelson* to reject a takings claim "when a municipality sold foreclosed property and retained the proceeds" because adequate notice of the foreclosure was provided.[90] The Court found the government's case in *Reinmiller* to be even "stronger than *Nelson*" because Oregon's statute explicitly excludes property owners from surplus proceeds, versus New York's statute in *Nelson*, which gave

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[86] *Id.* at *2.
[87] *Id.*
[88] *Id.* at *1.
[89] OR. REV. STAT. ANN. § 312.120 (West 2021) (failing to provide any avenue for property owners to claim surplus proceeds).
[90] *Reinmiller*, 2006 WL 2987707, at *2.

property owners a conditional right to the surplus.[91] The Court concluded it had no reason to "overturn settled Oregon law" and cited to *Nelson* once more to push this issue as one for state legislatures.[92]

The *Reinmiller* court oversimplifies and mischaracterizes *Nelson*'s holding. *Nelson*, as discussed, primarily examines procedural due process and adequate notice procedures. *Nelson's* discussion of takings is a single sentence and discussed in tandem with the substantive due process claim.[93] Because takings law has developed further since *Nelson*, *Nelson* is not the reigning authority for how courts should decide a takings claim attacking a surplus retention law.[94] Most importantly, *Nelson*'s holding on takings is limited to protecting state surplus retention when "there is a statutory path to recover the surplus proceeds but the property owners fail to avail themselves of that procedure."[95] *Nelson* characterizes New York's statute as one that did *not* "absolutely preclude[] an owner from obtaining the surplus proceeds of a judicial sale."[96] In stark contrast, Oregon's statute *does* absolutely preclude property owners from obtaining the surplus proceeds.[97] Because *Nelson*'s holding is limited to statutes that do not absolutely preclude property owners from surplus proceeds, *Reinmiller* misapplies *Nelson*.[98] Unfortunately, other courts also fail to distinguish between the surplus retention laws *Nelson* found constitutional and those being challenged.

In *Tyler*, Minnesota's District Court rejected a takings challenge to its surplus retention law.[99] Tyler owed $15,000 in taxes, and the County "foreclosed on Tyler's property, sold it for $40,000, and

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[91] *Id.* at *3.
[92] *Id.*
[93] Nelson v. City of New York, 352 U.S. 103, 109 (1956) ("In their reply brief, appellants urged that ... they are deprived of property without due process of law or have suffered a taking without just compensation.").
[94] *See supra* note 83 and accompanying text.
[95] Rafaeli, LLC v. Oakland Cnty., 952 N.W.2d 434, 453 (2020).
[96] *Nelson*, 352 U.S. at 109.
[97] *See supra* note 89 and accompanying text.
[98] *Rafaeli*, 952 N.W.2d at 453 ("What *Seaman*, *Lawton*, and *Nelson* do not tell us, however, is what occurs when the statutes governing foreclosure make no mention of, or expressly preclude, a divested property owner's right to the surplus proceeds ...").
[99] Tyler v. Hennepin Cnty., 505 F. Supp. 3d 879, 895 (D. Minn. Dec. 4, 2020) (finding that the County did not violate its surplus retention law and dismissing Tyler's claim.).

kept all of the proceeds."[100] Minnesota does not provide property owners a right to claim the surplus proceeds, unlike New York in *Nelson*, or a redemption period to buy back the property, unlike Oregon in *Reinmiller*.[101] The Court found Tyler's case to be similar to *Nelson,* though New York's statute gave a property owner a conditional right to the surplus.[102] The Court reasons that the Minnesota statute excluding property owners from any right to the surplus makes "the plaintiff's takings claim *even weaker* than the (unsuccessful) takings claim of the plaintiffs in *Nelson*."[103]

As mentioned before, *Nelson* barely discusses the plaintiff's takings Claim, the Supreme Court's takings law has developed since *Nelson*, and *Nelson*'s holding is limited to state surplus retention laws that give property owners a conditional right to the surplus (unlike Minnesota).[104] And even more critically, *Nelson*'s dicta implies that if the statute *did* bar the owner from the surplus (like Minnesota's statute), the Court may have ruled differently on substantive due process grounds.[105] Like *Reinmiller*, *Tyler* misapplies *Nelson*.

Tyler does highlight an important question—how do property owners have property interests in the surplus when the state does not give this interest—but again misapplies *Nelson*. *Nelson* dealt with a statute that *did* provide property owners with an interest in the surplus, while Minnesota's statute in *Tyler* does not.[106] Yet *Tyler* interprets *Nelson* to hold that a "former owner has a property interest in the surplus only if a provision of a constitution, statute, or municipal code creates such an interest."[107] *Nelson* does not comment on statutes that do not provide rights in the surplus, not to mention if a former owner would have a property interest in such a case. To construe *Nelson* as commenting on a different kind of statute and property interest is pure

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[100] *Id*. at 883.
[101] MINN. STAT. ANN. § 282.08 (West 2020) (distributing net proceeds to government and not to property owner).
[102] *Tyler*, 2020 WL 7129894, at **9 ("Minnesota's tax-foreclosure scheme, unlike ... the New York City Code at issue in *Nelson*, does not give the property owner even a conditional right to the surplus.").
[103] *Id.* at *10 (emphasis added).
[104] *See supra* notes 94–98 and accompanying text.
[105] Nelson v. City of New York, 352 U.S. 103, 109 (1956) ("But we do not have here a statute which absolutely precludes an owner from obtaining the surplus proceeds of a judicial sale.").
[106] *Id.*; *Tyler*, 2020 WL 7129894, at *10 ("Minnesota's [tax-forfeiture scheme] gives the property owner no right to the surplus.").
[107] *Id.*

extrapolation. But this does raise an important question of where the property owner's interest in the surplus arises, if not from state law.

"Property interests, of course, are not created by the Constitution."[108] Plaintiffs must first show the source of their property interest before they can launch a constitutional challenge to protect this interest. [109] Here, property owner plaintiffs must show the source of their property interest in the surplus *independent* of state law because the eight state laws explicitly preclude giving property owners any right to surplus. [110] The Michigan Supreme Court in *Rafaeli* (1) demonstrates how property owners can prove they have a property interest in the surplus proceeds and (2) provides a blueprint for how courts can find surplus retention laws unconstitutional.[111] The next section discusses the claims plaintiffs can bring to court as guided by the *Rafaeli* decision, which found Michigan's surplus retention law unconstitutional under both the state and federal Takings Clauses.[112]

IV. Plaintiffs' Claims in Constitutional Challenges to Surplus Retention Laws

This section details property owners' best claims against the surplus retention laws—federal and state takings claims.

A. Federal Takings Claims

The Fifth Amendment provides that "private property [shall not] be taken for public use, without just compensation."[113] The Supreme

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[108] Bd. of Regents v. Roth, 408 U.S. 564, 577 (1972).
[109] *Id.* at 579 (finding no Fourteenth Amendment violation because plaintiff did not have a valid property interest to be protected).
[110] *Id.* ("[Property interests] are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law ...").
[111] Rafaeli, LLC v. Oakland Cnty., 952 N.W.2d 434 (2020).
[112] *Id*. at 484–85 ('defendants' retention and subsequent transfer… amounted to a taking of plaintiffs' properties under Article 10, § 1 of our 1963 Constitution.").
[113] U.S. CONST. amends. V, XIV.

Court has unambiguously held that the Fifth Amendment Takings Clause also applies to the states, per the Fourteenth Amendment.[114]

1. *Rafaeli Provides the Blueprint for How the Common-Law Supports Property Owners' Freestanding Property Interest in the Surplus*

Before property owner plaintiffs can launch a Takings Clause violation, they need to show they have a property interest to be protected.[115] They should look to *Rafaeli* as a blueprint. Michigan's surplus retention law, like the eight state surplus retention laws discussed, excluded property owners from the surplus.[116] For the Michigan Supreme Court to find the law unconstitutional, they first had to find the source of a property owner's right to the surplus—in the common law.[117]

The *Rafaeli* court found support for this common law right in a variety of sources. In English common law, property owners would keep the surplus from tax sales—"tax collectors could only seize property to satisfy the value of the debt payable to the Crown, leaving the property owner with the excess."[118] The early Michigan Supreme Court in 1867 also espoused that the government should not keep more than it is owed in a tax foreclosure sale—"[n]o law of the land authorizes the sale of property for any amount in excess of the tax it is legally called upon to bear."[119] Further support comes from the study of eminent domain, as "the government shall take no more property than necessary for the

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[114] Chicago, Burlington & Quincy R.R. v. City of Chicago, 166 U.S. 226, 241 (1897) (holding that states are prohibited from taking private property without just compensation by the Fourteenth Amendment).
[115] Phillips v. Wash. Legal Found., 524 U.S. 156, 172 (1998) (finding plaintiffs did have a property interest in interest proceeds in IOLTA accounts to launch a takings claim).
[116] MICH. COMP. LAWS ANN. § 211.78m(8) (West 2021) ("A foreclosing governmental unit shall deposit the proceeds from the sale of property under this section into a restricted account designated as the 'delinquent tax property sales proceeds for the year ________.'").
[117] *Rafaeli*, 952 N.W.2d at 454 ("Therefore, we must determine whether plaintiffs have a vested property right to these surplus proceeds through some other legal source, such as the common law.").
[118] *Id.* at 455.
[119] *Id.* at 456 (quoting Case v. Dean, 16 Mich. 12, 19 (1867).

particular public use for which the taking was done."[120] The Michigan Supreme Court has also allowed, under a theory of unjust enrichment, for a property owner to sue for return of surplus proceeds.[121] From this lengthy historical support, *Rafaeli* found that Michigan's common law recognizes a property owner's right to surplus proceeds.[122]

a. Viviano's concurrence in *Rafaeli* provides more common-law support for a property-interest, but protects property owners' interest even more—in the *equity* and not just the surplus.

Viviano's concurrence in *Rafaeli* provides additional common law support for a property-interest in the surplus, but this support expands to not only cover the surplus but also property owners' *equity* right in their property.[123] In fact, the wealth of common law support for an *equity* interest in the property described below—as seen in mortgage foreclosure law, divorce law, and bankruptcy law—stretches beyond common-law support for just a surplus interest. This informs why I argue in Section V that courts should recognize a common law interest in the equity, not just the surplus.

In the early days of English common law, if a property owner mortgaged their property and defaulted, the entirety of the property was forfeited to the mortgagee.[124] This practice is markedly similar to

[120] *Id.*

[121] *Id.* at 458 ("*Dean* stands for more than just a recognition of the plaintiff's right to bring a claim under unjust enrichment for the surplus proceeds. Inherent in *Dean's* holding is Michigan's protection under our common law of a property owner's right to collect the surplus proceeds that result from a tax-foreclosure sale.").

[122] *Id.* ("Having originated as far back as the Magna Carta, having ingratiated itself into English common law, and having been recognized both early in our state's jurisprudence and as late as our decision in *Dean* in 1976, a property owner's right to collect the surplus proceeds from the tax-foreclosure sale of his or her property has deep roots in Michigan common law.").

[123] Rafaeli v. Oakland, 952 N.W.2d 434, 486 (2020) (Viviano, J., concurring) ("Doing so, I conclude that the property right that has been taken from the plaintiffs is their equity in their respective properties and not any independent interest in the surplus proceeds from the tax-foreclosure sale.").

[124] Thomas W. Bigley, *Property Law—the Equity of Redemption: Who Decides When It Ends?*, 21 WM. MITCHELL L. REV. 315, 318–19 (1995) ("English mortgage law presented a cruel reality to the mortgagor. Under the common

government retention of surplus proceeds; if a property owner is delinquent on their property taxes, the entirety of the property's equity is forfeited to the government. However, the English courts recognized the unfairness in this mortgage foreclosure practice, so they gave mortgagors rights in the property mortgaged, called "the principle of equitable redemption." [125] Today, this right is commonly referred to as "equity of redemption," because if a mortgagor defaults, the mortgagee can only take what is owed while the mortgagor keeps the remaining equity.[126] The "equity of redemption" serves to protect a homeowner's "equity" interest in the home.[127] In the case of a foreclosure sale, the homeowner also keeps the remaining equity, in the form of surplus proceeds.[128]

As mentioned in the Introduction, *supra*, because the private sector allows mortgagors to keep their *equity* in their property during a foreclosure sale, a property owner's right during government tax foreclosure should also be an *equity* right to align to this well-established legal reasoning.[129] Creating an *equity* right in the case of private sector mortgage foreclosures but only a *surplus* right in the case of government delinquent tax foreclosures implies that property owners

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law, any land securing a debt vested completely in the mortgagee. The mortgagor's title to the land would terminate immediately upon default.").

[125] *Id.* at 319 ("In response, English courts developed the principle of equitable redemption to end property forfeitures caused by simple defaults of mortgage agreements. Equity intervened to ensure that a mortgagee did not use the secured transaction as a means to acquire the mortgagor's property.").

[126] *Equity of Redemption (Mortgage Equity or Property Equity),* WOLTERS KLUWER BOUVIER LAW DICTIONARY (Desk ed. 2012) ("Equity of redemption, often referred to merely as "equity" or the "equity in one's property," refers to the value of the right of a mortgagor in the property that has been mortgaged ... [T]he amount of the mortgagor's equity is the difference in the value of the underlying property and the encumbrances upon it in mortgages and liens.").

[127] Rafaeli, LLC v. Oakland Cnty., N.W.2d 434, 478 (2020) (Viviano, J., concurring) n.50 ("Thus, perhaps it is more accurate to say a redemption right functions to protect a homeowner's equity interest.").

[128] *Id.* at 479 ("Thus the creation of "equity" led to the homeowner's right to surplus proceeds from foreclosure sales.").

[129] Michigan, for example, statutorily requires surplus proceeds after a mortgage foreclosure sale to be distributed back to the mortgagor. MICH. COMP. LAWS ANN. § 600.3252 (West 2021) ("If after any sale of real estate ... there shall remain ... any surplus money after satisfying the mortgage on which the real estate was sold, and payment of the costs and expenses of the foreclosure and sale, the surplus shall be paid over by the officer or other person on demand, to the mortgagor.").

have less rights when the foreclosing entity is the government.[130] Courts have not provided sufficient reasons to justify this unfair discrepancy. If it is incentives-based, this reasoning is incoherent since even the *profit-oriented* private sector allows mortgagors to keep their equity.[131] The equity of redemption in mortgage foreclosure law is strong evidence that homeowners have an equity interest in their property even during a tax foreclosure.

In divorce proceedings, courts use the value of home equity to determine the amount distributed to each separated spouse.[132] Furthermore, when the home is considered to be marital property, net proceeds from the home's sale are distributed to the spouses as part of the net marital *equity* in the property.[133] In other words, when there are competing property interests between spouses, it is home equity that is proportionally distributed. When the home is sold, the proceeds are part of the marital equity that is distributed. Following this logic, a property owner, just like a spouse, has an equity interest in their home, and a proportional distribution between the competing interests—the government interest and the property owner's interest—results in the government keeping only the taxes owed and the property owner retaining the remaining equity. Similarly, when the home is sold, the net proceeds should be considered as part of the equity in the property, and the property owner retains this equity interest in the home.

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[130] Foos, *supra* note 12, at 95 n.6 ("Redemption of the surplus by the foreclosing governmental unit is completely contrary to mortgage foreclosure law, which requires mortgage companies to return the surplus funds from the foreclosure sale to the borrower.").

[131] *Id.*

[132] Nathey v. Nathey, 292 So. 3d 483, 485 (Fla. Dist. Ct. App. 2020) (finding that while spouse did not own the home, because spouse contributed to the mortgage and home equity line of credit, spouse was owed the proportional value of "any increase in the property's *equity* due to these payments") (emphasis added); Mundy v. Mundy, 2016 PA Super 256, 151 A.3d 230, 237 (2016) (using "the net home *equity* at the time of marriage" to calculate the net marital value of Husband's premarital property) (emphasis added); Barrett v. Barrett, No. M2000-00380-COA-R3CV, 2001 WL 1216984, at *3 (Tenn. Ct. App. Oct. 12, 2001) (calculating $15,000 of marital equity from an increase in home equity).

[133] J.G.L., 295 S.W.3d 424, 429 (Tex. App. 2009) (finding trial court did not abuse its discretion when "awarding $55,000 of equity from the sale of the residence to Wife."); Zitelli v. Zitelli, No. 0122-94-4, 1995 WL 23964, at *1 (Va. Ct. App. Jan. 24, 1995) (finding that the trial court "should have considered the net proceeds from the sale as net marital equity in the property.").

In bankruptcy proceedings, debtors can exempt their homes from being sold by using either the federal homestead exemption or their state's homestead exemption. [134] Under the federal exemption, homeowners can exempt up to $170,350 of their home equity from the bankruptcy sale.[135]At the state level, homestead rights appear not only in state statutes but also in state constitutions.[136] In fact, Minnesota has defined homestead rights in its constitution and in law. [137] That homeowners can exempt their home equity from bankruptcy implies that homeowners have an equity interest in the home. This property interest is so strong, especially in states like Minnesota that have provisions in both their constitution and laws to provide homestead rights, that courts have "construed these provisions liberally in favor of the debtor due to their constitutional roots and the strong social policy of securing the home against the uncertainties and misfortunes of life."[138]

Homeowners still have equity interests in their home while there are competing interests, whether it be in mortgage foreclosure, divorce, or in bankruptcy, which lends credence to a finding of a common-law backed equity interest in the property.

[134] *In re* Morgan, 607 B.R. 880, 882 (Bankr. S.D. Tex. 2019) ("In a bankruptcy case, a debtor may use the federal homestead exemption or elect to use the homestead exemption of his state of domicile.").
[135] 11 U.S.C.A. § 522 (West, Westlaw through Pub. L. No. 116-252) ("[A] debtor may not exempt any amount of interest ... that exceeds in the aggregate $170,350 (A) real or personal property that the debtor or a dependent of the debtor uses as a residence ...").
[136] *Morgan*, 607 B.R. at 885 ("Texas homestead rights have constitutional and statutory origins.").
[137] Minn. Const. art. 1, § 12 ("A reasonable amount of property shall be exempt from seizure or sale for the payment of any debt or liability. The amount of such exemption shall be determined by law."); Minn. Stat. Ann. § 510.01 (West) ("The house owned and occupied by a debtor as the debtor's dwelling place, together with the land upon which it is situated to the amount of area and value hereinafter limited and defined, shall constitute the homestead of such debtor and the debtor's family, and be exempt from seizure or sale under legal process on account of any debt not lawfully charged thereon in writing.").
[138] *In re* Mus, 598 B.R. 623, 626 (Bankr. D. Minn. 2019).

2. *Once the Court Recognizes a Property Right in the Surplus, a Finding That a Taking Occurred Necessarily Follows*

If the property owner plaintiffs can successfully persuade the court that they have a property-interest in the surplus, then it is unconstitutional for a state to deprive them of their property right through a surplus retention statute that does not provide an avenue to receive the surplus.[139] But if the property owner plaintiffs can't persuade the court to find they have a property-interest in the surplus, the plaintiffs have no constitutional violation to assert.[140]

B. State Takings Claims

The analogous state-level claims follow a similar process with an additional step: (1) The plaintiffs must allege a violation of their state's constitutional Takings Clause, (2) prove that there is a common-law right to the surplus, and (3) also prove the state's surplus retention law did not abrogate the common-law right.[141]

Michigan's Takings Clause states that "[p]rivate property shall not be taken for public use without just compensation … "[142] The *Rafaeli* court found "the ratifiers of the 1963 Michigan Constitution would have commonly understood this right [to the surplus] to be protected under Michigan's Takings Clause."[143] While the state legislature can abrogate a common law right, it can't abrogate a right protected by the state Constitution. Because the ratifiers considered surplus as part of "private property" when they ratified the Michigan

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[139] Nelson v. City of New York, 352 U.S. 103 (1956) (finding surplus retention only constitutional with adequate notice and an avenue for property owners to claim the surplus).

[140] Ritter v. Ross, 558 N.W.2d 909, 912 (Wisc. Ct. App. 1996) (finding no federal takings violation when government retained surplus and the statute did not provide for how surplus is distributed because the statute, being silent, also did not give a property right in the surplus to the property owner).

[141] Rafaeli, LLC v. Oakland Cnty., 952 N.W.2d 434, 459 (2020). ("A claimant must first establish a vested property right under state law ... the plaintiff must have had a common-law right to these surplus proceeds ... the question now becomes whether the amendments of the GPTA abrogated this common-law right.").

[142] MI CONST Art. 10, § 2 (West).

[143] *Rafaeli*, 952 N.W.2d at 459.

Constitution, a state surplus retention law cannot abrogate the right in the surplus.[144]

Once a property owner plaintiff has followed the analogous steps with their state's Takings Clause and proved the ratifiers' understanding of property when the state constitution was ratified, they can similarly prove that surplus is part of the "property" protected by the Takings Clause. While this seems straightforward, what constitutes the definition of "property" is anything but and subject to the unpredictable waves of judicial interpretation.

C. Procedural Due Process

Notice issues in tax foreclosure proceedings appear most often with (1) notice of the delinquent tax and (2) notice of the impending tax foreclosure on the property.[145] These are issues with *actual* notice. The common argument is that if property owners don't receive actual notice of a delinquent property tax or the imminent sale of their home, they don't have a chance to pay the tax off or prevent the sale.[146] However, fairness did not factor into the Supreme Court's analysis in *Nelson*.[147] The Court required only for notice *procedures* to be satisfied, foreclosing the argument of actual notice.[148]

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[144] *Id.* at 466 ("This right continued to exist even after fee simple title to plaintiffs' properties vested with defendants, and therefore, defendants' retention and subsequent transfer of those proceeds into the county general fund amounted to a taking of plaintiffs' properties under Article 10, § 2 of our 1963 Constitution.").

[145] *In re* Beckham, 447 B.R. 603, 605 (Bankr. E.D. Mo. 2011) ("Plaintiff contends that he did not have actual or constructive notice of the Tax Sale, did not have any knowledge of the tax delinquency and that he only became aware of the Tax Sale when he received notice of the Tax Sale confirmation hearing, which was mailed to the Property.").

[146] Foos, *supra* note 12, at 94. ("Calley paid her property taxes for 2012 but was unaware she missed one payment for tax year 2011. While Kalamazoo County later claimed that it attempted to inform Calley of her delinquent tax status seven times over the next year, Calley stated that she did not receive any notice that she was late on her taxes until it was too late to redeem the property. Even though Calley offered to pay the taxes and fees owed on the property and had the means to do so, in 2013 Kalamazoo County sold Calley's $156,000 house for $80,000 over a $2,000 tax dispute.").

[147] Nelson v. City of New York, 352 U.S. 103, 110 (1956) ("It is contended that this is a harsh statute.").

[148] *Id.* at 108–09 ("We conclude, therefore, that the City having taken steps to notify appellants of the arrearages and the foreclosure proceedings and their

Unless the Supreme Court revisits the issue of actual notice in surplus retention, plaintiffs must demonstrate inadequate satisfaction of notice procedures to have a strong procedural due process claim.[149] Still, there is compelling anecdotal evidence in the case law to highlight if the Supreme Court does revisit this issue. As a policy matter, the purpose of notice should be to inform property owners of what legal proceedings may come. In practice, notice is a box for state governments to check off before they steal a property owner's equity.[150]

In *Nelson*, notices were mailed to the properties but were concealed by the property owners' bookkeepers, so the property owners were not aware of delinquent payments the bookkeeper failed to make or the later foreclosure sale.[151] In *Beckham*, the city of St. Louis failed to send notice to the correct property owner's name and correct address.[152] The city sent notice to an incorrect name and address listed on the deed, even though the correct name and address were also listed on the deed.[153] In both instances, because the foreclosing governmental units followed statutorily required notice procedures and the standard is only "reasonably calculated" notice, not actual notice, the property owners had no recourse.[154] This standard disproportionately impacts people who are disabled, elderly, or ill, because they often rely on caretakers or guardians to make payments, and do not have actual notice

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agent having received such notices, its application of the statute did not deprive appellants of procedural due process.").

[149] *Id.*

[150] *See supra* note 146 and accompanying text.

[151] *Nelson*, 352 U.S. at 107 ("Appellants contend they received no actual notice of the foreclosure proceedings. The reason they assign is that the mailed notices were concealed by their trusted bookkeeper, who is also alleged to have concealed from them the nonpayment of the water charges. There is no claim that the bills for the water charges were not mailed to the estate.").

[152] *In re* Beckham, 447 B.R. 604, 606 ("No notice was served upon "Lawrence Beckham" or the Property ... Collector of Revenue served notice on "Lawrence Beckman" and mailed the notice to 1424 South 18th Street, St. Louis, Missouri, as listed on Page 1 of the Deed, despite the accurate listing of Plaintiff's name and actual address on the Deed's Grantee Rider, located on Page 4 of the Deed.").

[153] *Id.*

[154] *Nelson*, 352 U.S. at 105 ("It is undisputed that the statutory notice requirements were satisfied in this case"); *Beckham*, 447 B.R. 604, 607 ("The Missouri Supreme Court has already explained that the MLRL "is reasonably calculated to reach tax delinquent property owners." (quoting Collector of Revenue v. Parcels of Land, 585 S.W.2d 486, 488 (Mo.1979))).

of delinquent payments and imminent government sale of their homes until it is too late.[155] Homeowners cannot look to adequate notice procedures to protect them from governments stealing home equity.

V. An Equity Right in the Property Is More Aligned with the Common Law and Protects Property Owners More Than a Surplus Right

Instead of structuring the property owner's right as a freestanding right in just the *surplus*, Viviano's concurrence in *Rafaeli* argues that property owners have vested *equity* rights tied to their property.[156] By virtue of owning property, property owners have equity rights in the property, and when title vests in the government because of delinquent taxes, property owners still have an equity right in the value of the property, just minus the taxes.[157] As mentioned, there is a wealth of common law support for an equity right in the analogous private mortgage foreclosure market and in divorce law and bankruptcy law.[158] The common law provides even more support for an equity right in the property than just a right in the property's surplus.[159] But most importantly, an equity right protects property owners more than a

[155] Foos, *supra* note 12, at 105. ("Furthermore, surplus retention systems are more likely to harm the most vulnerable populations, including the elderly, mentally disabled, and ill. These people generally are less able to take care of themselves, which increases the possibility that they will not pay their property taxes unless someone else assures the payment is made. Many people who are disabled or ill have a caretaker or guardian qwho is supposed to be responsible for these issues, but oftentimes property tax payments slip through the cracks. Similarly, these groups of people are also less likely to have actual notice that they are behind on their payments. Many elderly or disabled people cannot pick up their own mail or may lose track of their mail, so although notices to them may be sent, they are not aware that they are behind on their property taxes until their property is sold.").

[156] Rafaeli, LLC v. Oakland Cnty., 952 N.W.2d 434, 483 (2020) (Viviano, J., concurring) ("In short, the relevant property right in this case is the taxpayers' equity interest, not some contingent right to proceeds if there is a foreclosure sale.").

[157] *Id.* at 485 ("The better view, under the law described above, is that the property taken is the taxpayer's equity and that this occurs when title vests in the government with no opportunity for redemption.").

[158] *See infra* Section IV. A. 1. a.

[159] *See infra* Section IV. A. 1. a.

surplus right *and* aligns foreclosing governmental interests with the federal government policy of helping homeowner's build their equity.

A. An Equity Right in the Property Protects Property Owners When the Property Is Kept by a Governmental Unit or Not Sold at Auction

In *Nelson*, one plaintiff owed New York City $65, and the city sold his property for $7,000, while another plaintiff owed the city $814.50, and the city kept his property, valued at $46,000, without a sale.[160] With just a surplus right, the latter property owner loses all home equity because there was no sale, and therefore no surplus proceeds. With an equity right, the latter property owner has recourse with the City to compensate him for the lost equity in his property. Viviano highlighted this as a major downfall of *Rafaeli* majority's decision, and he correctly predicted that property owners would still face unfair outcomes after the surplus retention law was found unconstitutional.[161]

In Michigan, if the state, city, village, township, or county turn down their option to purchase the property from the foreclosing governmental unit, and the property goes unpurchased at auction, the property is transferred to one of those governmental units.[162] Therefore, there is no sale, no surplus, and most importantly, no avenue for a property owner to recoup their lost equity.[163] Also built into this process is the various governmental units' option to purchase the property at a minimum bid, which would also result in no surplus.[164] Every government is sensitive to maximizing their budget, so, under this regime, "a rational governmental actor is incentivized to buy properties

[160] Nelson v. City of New York, 352 U.S. 103, 110 (1956) (finding both plaintiffs without a claim to the profits).
[161] *Rafaeli*, 952 N.W.2d 434, 483–85 (Viviano, J., concurring) ("My difference of opinion with the majority on this point is no small matter ... because no surplus would result, the majority leaves the taxpayer without a remedy.").
[162] *Id.*
[163] *Id.* ("Consequently, the majority's view of the case would seemingly be that if the property does not sell at auction and is simply transferred to a governmental unit, the taxpayer is out of luck: no proceeds, let alone a surplus, have been produced or retained by the government.").
[164] *Id.* (describing how a governmental unit has multiple opportunities to purchase property for the minimum bid, meaning the debt and costs, which is usually significantly lower than fair market value, leaving the taxpayer without a remedy because there is no surplus).

that have a market value above the minimum bid amount" and "limit or eliminate surpluses."[165]

These harms are not conjecture. Less than one year after the *Rafaeli* ruling, and with the same defendant, the Eastern District of Michigan decided property owners who lost hundreds of thousands of dollars in equity had no recourse because there was no surplus. [166] Hall, who owed $22,642 in taxes, saw their property sell for $308,000, a difference of $285,358.[167]

Discerning readers will wonder why I say Hall had no surplus to claim in one sentence, then in the next sentence show that there was a resale with a huge profit, the surplus. In Michigan, when properties are foreclosed, the property titles vest in the county treasurer, or in Hall's case, the Oakland County Treasurer.[168] Then, a governmental unit can exercise its statutory right of first refusal, which allows the government to purchase properties at the minimum amount, the amount delinquent. [169] The City of Southfield did just that, exercising its statutory right of first refusal, by buying properties at a price equal to the taxes owed.[170] Therefore, there was no surplus. Under *Rafaeli*, the rule is no surplus, no recourse, so the analysis typically ends here. But the line of transactions kept going.

The City of Southfield quit-claimed the properties to a non-profit for just $1 each, and it was the non-profit that resold the property for large sums of money.[171] Providing property rights in the surplus solves only the problem of governments profiting from surplus retention, but here, where the non-profit profited, there are no protections. Yet there is more to this non-profit than meets the eye—the non-profit's board consists of powerful Southfield government officials, including

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[165] *Id.* at 486.

[166] Hall v. Oakland Cnty. Treasurer, No. 20-12230, 2021 WL 2042298, at *10 (E.D. Mich. May 21, 2021) ("*Rafaeli* does not recognize a right to recover alleged equity in property after a foreclosure.").

[167] *Id.* at *2.

[168] *Id.* ("After three years of delinquency, multiple notices and various hearings, tax-delinquent properties are forfeited to the county treasurer; foreclosed on after a judicial foreclosure hearing by the circuit court, and title to the forfeited property is transferred to the county treasurer; and, if the property is not timely redeemed by March 31 of that year, fee simple title is vested absolutely in the county treasurer, without any further redemption rights available to the delinquent taxpayer.").

[169] *See* note 164 and accompanying text.

[170] *Hall*, 2021 WL 2042298, at *2.

[171] *Id.*

the mayor and a city administrator responsible for over 1/3 of the City's budget.[172] This practice of systematically foreclosing on properties, buying them at exactly the price of the tax so as to have no surplus, giving these properties to a non-profit controlled by the government for a pittance, and then using the non-profit as a vehicle to make hundreds of thousands of dollars is dubious. At best, the City is exploiting a loophole, selling properties to a non-profit they control, so the profits can't be returned to property owners as surplus. At worst, government officials are lining their pockets by selling foreclosed homes for a pittance to their non-profit, and then using the non-profit to flip the homes for hundreds of thousands of dollars—their paychecks.

If property owners had an equity right, this scheme could not exist. But property owners only have a surplus right, so Michigan officials can continue appropriating property owners' rightful equity. This, despite the fact that *Rafaeli* found a Takings Clause violation, and the Takings Clause serves to protect people from government overreach.

Hall shows how a surplus right is a right in name only, lip service to true protection from government takings. *Rafaeli* all but stamped a seal of approval for government officials to loophole around giving surplus back to property owners. But discussing the officials' motivations to exploit this loophole borders on entering the field of investigative journalism, which is not within the realm of this Note. *Hall* illustrates that an equity right is property owners' best tool to protect against government takings.

B. The Fair Market Value Approach Is the Best Method of Estimating Property Equity and Incentivizes Governments to Host Fair Auctions.

After establishing a protected equity right in the property, there comes the problem of valuing equity. Fortunately, just as there is a large body of literature supporting the equity right, there is also a well-established methodology to valuing equity—Fair Market Value.

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[172] *See About Southfield Nonprofit Housing Corporation*, SOUTHFIELD NON-PROFIT HOUSING CORPORATION, https://snhc.org/about-southfield-nonprofit-housing-corporation/ (last visited Oct. 26, 2021). https://perma.cc/MM4N-MSXW (showing that the Mayor of Southfield is Board President, a city administrator responsible for over 1/3 of the Southfield budget is the Board Second Vice President, and a councilman is Board Director).

1. Fair Market Value Is the Established Valuation Process in State Courts, Federal Courts, and the U.S. Tax Court

In assessing the value of property, state courts often estimate the property's fair market value, which is "the price which the property would bring when offered for sale by a willing seller who is not obligated to sell, and purchased by a willing buyer who is not compelled to buy."[173] Indeed, the Supreme Court has supported this fair market value formulation, remarking that the "willing buyer-willing seller test of fair market value is nearly as old as the federal income, estate, and gifts taxes themselves, and is not challenged here."[174] Surplus proceeds hinge on a sale occurring—if there is no sale, there is no surplus for the property owner to claim. But if property owners receive the fair market value, even if there is no sale of the foreclosed property, property owners have an equity right to the difference between the fair market value of their home and the delinquent taxes.[175] Furthermore, if the sale is conducted hastily and at an undervalued price, the property owner has a right to the equity that would have occurred in a willing buyer-willing seller situation.[176] For example, if a property owner owes $75,000 in taxes, and the government sells the property valued at $150,000 for $75,000, the property has an equity right to the $75,000 from the government. But under a surplus retention system the property owner would receive nothing because there were no surplus proceeds. Under a fair market value approach, because the government must pay the $75,000, governments are incentivized to not conduct fire-sales of properties and instead assist homeowners in paying back their delinquent taxes, which is better public policy.

Lastly, fair market value is the correct estimate of property equity because the tax-assessed value of a property is part of fair market

[173] St. Joe Minerals Corp. v. State Tax Comm'n of Missouri, 854 S.W.2d 526, 529 (Mo. Ct. App. 1993) ("Fair market value typically is defined as the price which the property would bring when offered for sale by a willing seller who is not obligated to sell, and purchased by a willing buyer who is not compelled to buy.").

[174] United States v. Cartwright, 411 U.S. 546, 551 (1973) (using fair market value to price mutual fund shares).

[175] *Id.*

[176] *Id.* ("The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.")

value determination.[177] Delinquent taxes on homes are often assessed via the home's fair market value, so it only makes sense that the property equity also be assessed at the fair market value.[178] Of course, the best way to value property is an appraisal that is often a point of argument.[179]

2. *Fair Market Value Is the Most Equitable Measure After High Property Tax Assessments*

In instances where homeowners' tax bills are artificially inflated and a main factor for their delinquent taxes and tax foreclosures, fair market value is the most equitable measure of home equity. The most egregious example of property tax inflation in recent memory occurred in Detroit. While Michigan's Constitution prohibits any property tax assessments greater than 50% of a property's market value, "[b]etween 2009 and 2015, the City of Detroit assessed 55%-85% of its residential properties in violation of the Michigan Constitution."[180] As a result, from 2011-2015, twenty-five percent of Detroit properties were both assessed at illegally inflated rates and foreclosed on for failure to pay delinquent property taxes.[181] Because the *Rafaeli* decision occurred only in 2020, Michigan's surplus retention statute was in full force; homeowners that lost their homes in tax foreclosure lost all home equity to the government.[182] The overassessment issue is particularly egregious because the government, in inflating the property taxes, is

[177] Estate of Kaplin v. Comm'r, 748 F.2d 1109, 1111 (6th Cir. 1984) (finding tax court erred in failing to consider tax-assessed value of property in determination of fair market value).

[178] 16 EUGENE MCQUILLIN, A TREATISE ON THE LAW OF MUNICIPAL CORPORATIONS § 44:140 (3d ed. 2020) (discussing fair market value as one of the main methods for market value determinations).

[179] *Id.* ("The assessment valuation of property is a formulation of an opinion, not an exact science.").

[180] Bernadette Atuahene, *"Our Taxes are Too Damn High": Institutional Racism, Property Tax Assessments, and the Fair Housing Act*, 112 NW. U. L. REV. 1501 (2018).

[181] *Id.* at 1514. ("Moreover, since lower-priced homes were over-assessed at a greater frequency and magnitude than higher-priced homes, we estimate that 25% of tax foreclosures among homes less than $8,000 in sale price were due to unconstitutional property tax assessments.")

[182] *See* Rafaeli, LLC v. Oakland Cnty., 952 N.W.2d 434, 466 (Mich. 2020) (holding that a foreclosing municipality must deliver surplus proceeds from a foreclosure sale to a property's title holder).

complicit in creating delinquent taxes where there would otherwise be no property taxes under a proper valuation of the property.

For example, a Detroit assessor claimed Mrs. B's was worth $46,000 when she had purchased it for $20,000, the same approximate value of similar houses in the neighborhood, and because her taxes were double what she expected, they quickly became delinquent.[183] When the county foreclosed on the home, it sold for $500.[184] $500 seems like a small profit for the county, but this homeowner qualified for a property tax exemption—due to being under the federal poverty line she did not even have to pay property taxes, but she didn't know about the program and to apply.[185] Therefore, the county robbed her of her home and gained $500 in the process.

If *Rafaeli* gave an equity right before Mrs. B's home was sold in tax foreclosure, and if the equity right was calculated using fair market value, Detroit would have had to pay Mrs. B either $46,000 (the value the government assessed the property) or $20,000 (the value Mrs. B purchased the home for).[186] Because it is unlikely Detroit wants to be saddled with paying $46,000, an overinflated estimate, the city is incentivized to clean up its property tax assessment system and assist its constituents in paying off their delinquent property taxes, or in Mrs. B's case, letting the constituents know they don't have to pay property taxes at all. In this way, homeowners have recourse where they otherwise would not.[187]

According to the model law for secured transactions, if the collateral sale is not commercially reasonable, the secured party must compensate to the debtor the difference between the fair market value

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[183] Atuahene, *supra* note 180, at 1503. ("The overinflated property tax assessments led to illegally high property tax bills ... She was unable to pay the inflated property tax bill.")
[184] *Id.* at 1504.
[185] *Id.* ("Mrs. B and her family live under the federal poverty threshold and hence qualify for the Poverty Tax Exemption, which means that they were not supposed to be paying the property taxes that led to their eviction in the first place.").
[186] *See Rafaeli*, 952 N.W.2d at 466 (holding that a foreclosing municipality must deliver surplus proceeds from a foreclosure sale to a property's title holder).
[187] MorningSide Cmty. Org. v. Wayne Cnty. Treasurer, No. 336430, 2017 WL 4182985, at *1, 4 (Mich. Ct. App. Sept. 21, 2017) (finding plaintiff failed to state a claim under the Fair Housing Act when arguing that Wayne County knew of its overassessment of homes and foreclosed on these homes, which resulted in discrimination against African-Americans).

of the collateral and the price of the sale.[188] This is to prevent secured parties from double-dipping. For example, secured parties could deliberately fail to advertise the sale, become the only bidder at the auction, and buy the collateral for a pittance.[189] Therefore, there would be no possible surplus from the sale to return to the debtor. Then, the secured party could turnaround and sell the collateral for profit, and the debtor has no recourse for this second sale.[190] This scheme, which the model law for secured transactions prevents, is analogous to the scheme described in *Hall*, where the foreclosing governmental party was selling to an entity controlled by government officials, which then flipped the property for a profit.[191]

If the secured party's sale was not commercially reasonable, courts require secured parties to compensate the debtor for the full fair market value of the collateral.[192] Similarly, in the property tax foreclosure context, where foreclosing governmental auctions are not found commercially reasonable, courts should require governments to compensate property owners for the difference of the sale price and the fair market value of their property. Just as this mechanism serves to incentivize secured parties to host fair auctions to receive the maximum value of the collateral, so too should governments seek to obtain the fair market value of the property at auction.

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[188] U.C.C. §9-610(b) ("Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable ..."); U.C.C. § 9-615(f) ("The surplus or deficiency following a disposition is calculated based on the amount of proceeds that would have been realized in a disposition.").

[189] Vic Hansen & Sons, Inc. v. Crowley, 203 N.W.2d 728, 730 (1973) (finding when vehicle was purchased for $2,253.52 from secured party, vehicle developed mechanical problems, and debtor defaulted on payments, secured party's sale to himself of the vehicle for $700 was commercially unreasonable).

[190] *Id.* (finding that the secured party bought collateral at foreclosure sale for $700 then resold it for $995).

[191] *See Id.*; Hall v. Oakland Cty., No. 20-12230, 2021 WL 2042298, at *12 (E.D. Mich. May 21, 2021).

[192] Weiner v. Am. Petrofina Mktg., Inc., 482 So. 2d 1362, 1364 (Fla. 1986) ("awarding the debtor an additional credit in the amount of the difference between the fair market value of the collateral as determined and the amount the collateral brought in a commercially unreasonable sale."); ITT Com. Fin. Corp. v. Riehn, 796 S.W.2d 248, 252 (Tex. App. 1990) ("the sale is not commercially reasonable, the lender is not wholly barred from seeking a deficiency; instead, he must give credit for the full fair market value of the collateral.").

A wrinkle in this analysis is that state law often gives governments the right of first refusal, the ability to purchase the property before it is put to auction, so governments can often circumvent the sale, and they typically purchase for the same price as the delinquent taxes.[193] I have no issue with the right of first refusal, but if it is used to circumvent returning property owner's rightful surplus or equity to them, as it seems in *Hall*, then governments using the right of first refusal should also be required to pay fair market value.

C. A More Equitable Measure—Application to *Nelson* and the Eight States

So far, this Note has focused on the effects of a surplus right versus an equity right in Michigan, but the remaining eight states that have surplus retention laws are ripe for change. This next section shows the positive effects an equity right can bring to property owners in these remaining states.

1. Property Equity Retention in States That Do Not Give Property Owners a Redemption Period Could See Major Changes

Arizona and Montana do not provide property owners with rights to the surplus AND do not provide a redemption period, so homeowners have even less time in which they can prevent losing all their home equity.[194]

In one case in Arizona, a property owner lost $727,443 of equity due to Arizona's draconian surplus retention law.[195] If these states had

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[193] *See* Hall v. Oakland Cnty., No. 20-12230, 2021 WL 2042298, at *12 (E.D. Mich. May 21, 2021) ("Accordingly, when property is taken to satisfy an unpaid tax debt, just compensation requires the foreclosing governmental unit to return any proceeds from the tax-foreclosure sale in excess of the delinquent taxes, interest, penalties, and fees reasonably related to the foreclosure and sale of the property – no more, no less.")

[194] ARIZ. REV. STAT. ANN. § 42-18267 (providing that the owner's failure to redeem the surplus before the deed is delivered to the state terminates any redemption rights); MONT. CODE ANN. § 15-17-322 (West 2021) (providing that there is no right to redeem the surplus, and stating any surplus funds are deposited to the county's general fund).

[195] Complaint at 58, Automatic Art v. Maricopa, No. CV 08-1484-PHX-SRB, 2010 WL 11515708 (D. Ariz. Mar. 18, 2010) (property owner lost property valued at $1,050,000).

adopted an equity right to property valued at fair market value, the Arizona property owner would have a claim to the $727,443 of equity, instead of losing it all to the government. With states that have surplus retention laws and do not provide a redemption period, once a sale is conducted, property owners don't even have a chance to buy back their property by paying the delinquent taxes. Property Equity Retention would dramatically change this landscape for property owners.

2. *Property Equity Retention in States That Provide a Temporary Redemption Period for Owners to Buy Back Their Property Could Also See Major Changes*

In these states, once the redemption period expires, property owners cannot buy back their property, so the outcome is just as harmful as in the above states, just delayed.[196] A sampling of anecdotes shows the same pattern of lost equity. In Alabama, a property owner lost his property over delinquent taxes of $1,135.96, and the property sold at auction for $11,000.[197] In Indiana, a property owner owed $4,608.05 in delinquent taxes and the property was sold for $25,000.[198] In Illinois, the Streets would have lost their family home worth a fair market value of $30,000 due to $1,316.97 of delinquent taxes if it were not for a kind circuit court that had extended the redemption period, during which they paid the delinquent amount.[199] In Oregon, Reinmiller owed Marion County $14,216.91 in delinquent taxes, and his property was sold for $167,000.[200] In all these anecdotes, property owners lost equity, but

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[196] *See supra* note 15 and accompanying text (listing and discussing all eight states with statutes that allow property equity retention under certain conditions only through a temporary redemption period).
[197] Complaint at 28, Clark v. Mobile, No. 06-0155-CG-C, 2007 WL 9717529 (S.D. Ala. Nov. 8, 2007).
[198] Stump v. St. Joseph Cnty. Treasurer, 33 N.E.3d 360, 361 (Ind. Ct. App. 2015) ("On October 24, 2007, the Property was sold at the St. Joseph County Delinquent Tax sale for $25,000.00. The Property was not redeemed and title was issued to the tax sale purchaser on January 15, 2009, generating a tax sale surplus of $20,391.95.").
[199] Application for a Tax Deed, 2018 IL App (5th) 170170, ¶ 4, 115 N.E.3d 974, 977, 981 ("Equity abhors forfeiture so much so that equity would allow a party time beyond the time established by statute to perform in order to save that party from an egregious forfeiture.").
[200] Reinmiller v. Marion Cnty., No. 05-1926-PK, 2006 WL 2987707, at *2 (D. Or. Oct. 16, 2006).

under a fair market value retention approach, the property owners would keep their equity.

3. *Home Equity Retention Even with Government Retention of Property and No Sale*

Government tax foreclosures do not always end in the sale of the home.[201] If there is only a right in the surplus, governments are incentivized to keep the value of the property for themselves and circumvent the market.[202] With an equity right valued by fair market value, homeowners can require the government to pay the difference between the delinquent property taxes and the home's equity. Governments would think twice before keeping property and must then pay for any property they keep.

4. *Comparison to Redemption Rights*

I end this discussion of an equity right in property by demonstrating how this right is stronger than redemption rights in terms of its legal grounding and the scope of its protection for homeowners. The right to redeem is a weaker protection than an equity right protected by a state's constitution because the right to redeem is a statutory right.[203] Therefore, the right is subject to the whims of a state legislature.[204] Once it is established that the equity right in property is protected by the state's constitution, the right is protected from shifts in the state legislature.

The nature of redemption periods is such that once they expire, the government retains the surplus. While some states may allow for courts to extend the redemption period in individual cases like

[201] Rafaeli v. Oakland, 952 N.W.2d 434, 485 (2020) (Viviano, J., concurring) ("If the property goes unpurchased after an auction, the city, village, township, or county can buy it for the minimum bid without needing a public purpose to do so.").
[202] *Id.* ("Perhaps worse still, governmental units have numerous opportunities to purchase the property for the minimum bid, i.e., for the debt (and costs), and thus obtain it for an amount that will usually be much less than fair market value.").
[203] Matter of City of Binghamton, 515 N.Y.S.2d 660, 661 (1987) ("The right to redeem property exists only as permitted by statute, under such conditions as the statute may attach.").
[204] *Id.*

previously mentioned, other state courts are prevented from extending the redemption period.[205] Of course, there is no expiration date embedded in the equity right.

The nature of redemption periods also provides that the governmental unit holds the equity until the property owner pays back the value of delinquent taxes and whatever additional penalty interest rates the state tacks on. In contrast, an equity right in the property requires the governmental unit to compensate the property owner as needed, and this follows the longstanding principle that the state "may not transform private property into public property without compensation, even for the limited duration of the deposit in court."[206]

VI. Conclusion

Homeowners have an equity right in the home that they own. When a government forecloses on a home due to delinquent taxes, the government should only keep the equivalent of the overdue taxes and nothing more. A government should not steal a homeowner's equity simply because the government has a claim to the delinquent taxes. Not only do basic concepts of fairness demand such a result, but so do federal policies promoting homeownership and the protection of home equity.

Rafaeli provides the groundwork for how homeowners can attack state surplus retention statutes as unconstitutional and the framework for bringing these cases to federal court. The equity right in property, which Judge Viviano argues for in *Rafaeli*, provides the most protection to homeowners. Courts in states that allow governments to keep tax foreclosure surplus proceeds should recognize homeowner's equity rights and find these surplus retention laws unconstitutional.

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[205] *Id.* ("The time fixed for redemption or answer is in the nature of a Statute of Limitations, and a court is precluded from extending the time to redeem.").
[206] Webb's Fabulous Pharmacies v. Beckwith, 449 U.S. 155, 164 (1980).