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William A. Cook

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EFFECT OF PURCHASE OF TAX TITLE BY MORTGAGEE AS AGAINST MORTGAGOR

WILLIAM A. COOK *

The recent case of *DeLaine et al v. De Laine et al.*,¹ decided October 8, 1947, presented to the Supreme Court of South Carolina, for the first time, the question whether a mortgagee may, as against a mortgagor, purchase at a tax sale and thereby obtain a title which will defeat the title of the mortgagor.

In that case, the pertinent facts were these: the assignee of two mortgages, both covering the same two tracts of land, entered into possession of the mortgaged premises in 1919 under an agreement with the mortgagor whereby he was to have possession for ten years, in consideration of which the mortgage debts would be satisfied. In 1921, the assignee assigned the senior mortgage to his wife. One of the tracts was, in 1926, placed in execution for non-payment of taxes, and was sold under such execution to the wife, who, at that time, was the assignee and holder of the senior mortgage and in possession of the mortgaged premises with her husband. Action for partition was brought in 1943 by the children of the assignees, both of them having died intestate. The sole devisee under the will of the mortgagor was later made a party defendant. The lower court held that the devisee of the mortgagor was owner in fee of the real estate in question.

The judgment of the lower court was unanimously affirmed. After disposing of claims to title by adverse possession or presumption of grant, the Court, speaking through Mr. Justice Fishburne said:

“By the weight of authority, a mortgagee cannot purchase the mortgaged property at a tax sale and thus acquire a title which will defeat the rights of the mortgagor, as the act of purchase at such sale is deemed to be for the protection of the mortgagee’s lien . . . It is regarded as inequitable to permit the mortgagee to acquire title by purchasing the property for delinquent taxes and

* Member Senior Class, University of South Carolina School of Law.

1. 211 S. C. 223, 44 S. E. 2d 442 (1947).

thereby defeat the title of the mortgagor. (Authorities cited.)

“These rules are especially applicable where the mortgagee is in possession of the mortgaged premises, and is therefore under obligation to pay the taxes thereon. (Authorities cited.)”

It will be observed that though the mortgagee was actually in possession, the Court apparently rests its decision on the broad ground that a mortgagee cannot, under any circumstances, acquire a tax title and thereby defeat the rights of the mortgagor.

The courts are generally in agreement that a mortgagee who is in possession of the mortgaged property cannot acquire a tax title which can be asserted, except for purposes of reimbursement, against the mortgagor or the owner of the equity of redemption.² The basis of the rule is that a mortgagee in possession is under the duty of paying the taxes, and to permit him to obtain title through his failure to perform this duty would be to allow him to take advantage of his own wrong.³

A fortiori, a mortgagee in possession cannot acquire a tax title as against the mortgagor where his possession is under an agreement which expressly requires him to pay the taxes.⁴

Though it seems settled that a mortgagee in possession cannot defeat the rights of a mortgagor by purchasing a title at a tax sale, the authorities are by no means in accord where the mortgagee is not in possession.

The weight of authority is that a mortgagee who has merely a lien on the mortgaged property cannot, so long as the relation of mortgagor and mortgagee exists, obtain title to the property as against the mortgagor by means of a tax sale, particularly where, by contract or otherwise, he has the right, in case the mortgagor permits the taxes to become delinquent, to pay the same and add the amount so paid to his claim.⁵ This right to pay the taxes is generally recognized independently of statute, and even in the absence of a clause in the mortgage permitting the mortgagee to pay the taxes and add them

2. 140 A. L. R. 318.

3. 140 A. L. R. 318; *Allen v. Dayton Hotel Co.*, 95 Tenn. 480, 32 S. W. 962 (1895).

4. *Dusenberry v. Bidwell*, 86 Kan. 666, 121 P. 1098 (1912).

5. 140 A. L. R. 302.

to the mortgage debt upon failure of the mortgagor to do so. Thus, it is said in *Ragor v. Lomax*:⁶

“But while it may not be the duty of the mortgagee to pay the taxes, it is clearly his right to do so, for he has a manifest interest in the protection of his mortgage title . . . The sum that he pays to discharge it [the tax lien] goes to increase the amount of his encumbrance, *even if not so agreed in the mortgage*, for it is the duty of the mortgagor to protect the security he has given.” (Italics added.)

In South Carolina this right is expressly given by statute. Section 2783⁷ gives any mortgagee or any judgment creditor the right to pay delinquent taxes and add them to the amount of the debt secured by his mortgage or judgment. Section 8712-1⁸ gives the same right when there is a clause authorizing the mortgagee to make such advances. Both sections further give such advancing creditor a first lien to the extent of taxes so paid, which is, in effect, a subrogation to the rights of the taxing power.

The principal reason advanced by those courts denying a mortgagee the right to purchase at a tax sale and thereby prevent the mortgagor from redeeming, is, that while it may not be his duty, it is his right to do so for the protection of his interest in the mortgaged property, and it is presumed that when he does so purchase, it is for the protection and not for the destruction of the regular title.⁹

In *Middleton Sav. Bank v. Bacharach*,¹⁰ it is said:

“A mortgagee is under no legal obligation to pay the taxes, certainly as between himself and the mortgagor; and yet he may be compelled to pay them in order to protect his mortgage . . . He may pay the tax and the amount will be added to his debt, and he will hold the whole property as security therefor. In such a case it is unnecessary to complicate the legal title with the tax deed, and the law will not allow it to be done. It simply makes it his duty to pay in default of the mortgagor.”

6. 22 Ill. App. 628 (1887).

7. Code of Laws of South Carolina, 1942.

8. *Ibid.*

9. 37 Am. Jur., Sec. 1163, p. 417; Sec. 714, Jones on Mortgages (7th Ed.); 140 A. L. R. 298; L. R. A. 1917D 523.

10. 46 Conn. 513 (1879).

Another reason for the rule is that it would be inequitable to permit the mortgagee to acquire title by purchasing at a tax sale and thereby defeat the title of the mortgagor. The mortgagor and mortgagee both having a unity of interest in the protection of their title, it is deemed inequitable that either of them should act adversely to the other in the preservation of the title in the maintenance of which they are both concerned.¹¹

On the other hand, there is considerable authority for the view that a mortgagee or other lien holder, who is not in possession of the encumbered premises and is not under a contractual obligation to pay the taxes thereon, may acquire and hold a tax title in his own right as against the mortgagor.¹²

The primary reason advanced by these courts is that though there may be a right in the mortgagee to pay the taxes and add them to the mortgage debt, it is nevertheless a right and not a duty. It is on this particular point that most of the cases differ—the majority, as pointed out above, saying that there is a presumption that he purchased for the purpose of protecting the regular title rather than for the purpose of destroying it, and the minority saying that no such presumption exists, but rather that such purchase indicates an intention on the part of the mortgagee to exercise his privilege of purchasing the property rather than that of protecting his lien.

In *Waterson v. Devoe*,¹³ the Court, in determining the effect of a statute giving a mortgagee the right to pay taxes, said:

“Such provision of the law gives him the choice, if he desires, of paying the taxes, and secures him in the way of a lien for the amount so paid. *It does not make it obligatory upon him to do so, nor does it create the relation of trust and confidence between him and the mortgagor.*”
(Italics added.)

In *Jones v. Black*,¹⁴ the right of the mortgagee to obtain such a title is upheld on the ground that to hold otherwise would be to allow the mortgagor to take advantage of his own

11. L. R. A. 1917D 524; *Eck v. Swennumson*, 73 Iowa 423, 35 N. W. 503 (1887); *Woodbury v. Swan*, 59 N. H. 22 (1879); *Eblen v. Major*, 147 Ky. 44, 143 S. W. 748 (1912).

12. 140 A. L. R. 297.

13. 18 Kan. 223 (1887).

14. 18 Okla. 344, 88 P. 1052 (1907).

wrong. The Court goes on to say that the local statute negated the idea of any title in the mortgagee, and, further, that the mortgagee's right to pay taxes did not make it obligatory upon him to do so.

Although reference is made in several cases to the possibility that the result in cases of this kind may depend upon whether the mortgage conveyed the title to the mortgagee or merely gave him a lien, according to an annotator in American Law Reports,¹⁵ the "only case" found in which the question has been squarely passed on is *Cauley v. Sutton*¹⁶ in which the Court, after stating that North Carolina followed the title theory, said:

"The legal estate passes to the mortgagee, and he holds it not only in trust for himself, but also for the mortgagor . . . When the mortgagee bought at the sheriff's sale he purchased only an encumbrance, the cost of which he is entitled to have added to the debt secured by the mortgage . . . He did not acquire the equitable estate of the mortgagor, which still exists, notwithstanding his purchase at the tax sale, and he cannot use his deed for the purpose of asserting any right in conflict with the mortgagor's equity of redemption."

In *Waterson v. Devoe*, *supra*, the Court states that the cases which support the rule that the mortgagee cannot obtain a tax title are made either in states where the common law prevails as to the character of mortgages (title theory), or in cases where the mortgagee was in the actual possession of the premises.

It may be stated that generally (with, of course, some exceptions) the states that follow the lien theory allow a mortgagee to obtain a valid tax title against the mortgagor in the absence of the mortgagee's possession of the mortgaged property or a contractual duty on his part to pay the taxes, while the states adhering to the title theory do not allow it, most of them taking the view that since the mortgagee has the title, his purchase at a tax sale merely amounts to the removal of an encumbrance which may be added to the mortgage debt.

15. 140 A. L. R. 317.

16. 150 N. C. 327, 64 S. E. 3 (1909).

Since, by Section 8701,¹⁷ South Carolina is a lien state, it would appear to be among the exceptions mentioned above, because, as previously pointed out, the decision in the principal case was apparently based on the broad principle that a mortgagee, in or out of possession, cannot acquire a tax title and thereby defeat the rights of the mortgagor.

Another conflict in the decisions arises in regard to the question whether the purchase of the mortgaged property by the mortgagee at a tax sale extinguishes the mortgage debt.¹⁸ The cases seem to be about evenly divided on this point.

The South Carolina cases, on the doctrine of merger, hold to the effect that purchase by the mortgagee at any judicial sale except a foreclosure sale to enforce his own lien, effects, as a general rule, an extinguishment of the mortgage debt.¹⁹

The case of *Devereux v. Taft*²⁰ sustains the general proposition that the purchase of land at a tax sale by the mortgagee extinguishes the debt secured by the mortgage on such land.

Later, in *Powell v. Patrick*,²¹ where a bond was secured by a real estate mortgage and a chattel mortgage, and the mortgaged land was purchased by the mortgagee at a tax sale, the Court, after discussing the law of merger generally and pointing out that in equity merger was primarily a matter of intention of the parties, held that the bond was not extinguished. The rights of the third parties had become involved, and the Court desired to protect the estate of the mortgagee in the personal property. It said:

“If the Court should declare that the debt was extinguished, the vested rights of the mortgagee as the legal owner of the personal property, after condition broken, or the rights of third parties, might thereby be injuriously affected. Under such circumstances, the Court, in the exercise of its chancery powers, will refuse to declare the debt extinguished.”

17. Code of Laws of South Carolina, 1942.

18. 95 A. L. R. 98.

19. *Snell v. Schroder*, Bailey Eq. 334 (1831); *McLure, Brawley, & Co. v. Wheeler*, 6 Rich Eq. 343 (1853); *Trimmier v. Vise*, 17 S. C. 500 (1882).

20. 20 S. C. 555 (1884).

21. 64 S. C. 190, 41 S. E. 894 (1902).

In *Ex parte Powell*,²² it was held that the purchase at a tax sale of one of the tracts of land covered by a mortgage covering two tracts extinguished the mortgage debt only to the extent of the real value—not the sale price—of the tract purchased.

In many of the states, it is held that such purchase of a tax title does not destroy the debt or affect the mortgagee's right to enforce it. The difference in the decisions seem to be attributable, in most instances, to the different applications of the law of merger as made by the courts. Intention, actual or presumed, of the person in whom the interests are united is generally the basis on which the decisions will rest.²³ But the courts are not uniform in their decisions as to the manner of determining intention, and this seems to be the true reason for the conflict in the decisions.²⁴

A question arises here as to the effect of the principal case on the South Carolina cases last mentioned above. In all those cases the mortgagee was permitted to buy the land. No question as to the propriety of such purchases arose, but the issue was whether the debt had been extinguished. In the principal case the debt had been extinguished by virtue of the agreement to give the mortgagee possession for ten years, and the question was the propriety of the purchase at the tax sale. Does this decision in effect overrule the earlier ones? Does it prevent a mortgagee, under any or all circumstances, from purchasing the mortgaged property at a tax sale except for the benefit of the mortgagor? Does the mortgagor have a right to elect which way the purchase shall be treated? The writer ventures no opinion on these questions.

It might be well to mention briefly the effect of the converse of the situation above discussed, i.e., the effect, as against the mortgagee, of the mortgagor's acquiring a tax title.

Almost without exception the cases support the general proposition that a mortgagor cannot buy in a tax title and assert it successfully against the mortgagee.²⁵ The basis usually suggested for the rule is that it is the duty of the mort-

22. 68 S. C. 324, 47 S. E. 440 (1904).

23. 95 A. L. R. 89.

24. 95 A. L. R. 90, 91.

25. 134 A. L. R. 290, and cases cited; 1 Glenn on Mortgages Sec. 43, p. 273; 2 Jones on Mortgages (7th Ed.) Sec. 680, p. 37.

gagor to keep the taxes paid and that he cannot be allowed to derive an advantage from his own wrong in permitting them to go unpaid.²⁶ In some cases the duty of the mortgagor has been attributed to particular covenants or conditions in the mortgage, and in others to the relationship between the parties, or to the fact that the mortgagor was in possession and receiving rents and profits therefrom.²⁷

This rule has been held to apply where such purchase is made by, or in the name of, another, but in the mortgagor's interest.²⁸

This question was passed on in South Carolina in *Interstate Bldg. and Loan Assn. v. Waters*.²⁹ In that case the mortgaged property had been purchased at a tax sale by the Sinking Fund Commission. The mortgagor then borrowed money and got a deed from the Sinking Fund Commission, but the deed was taken in the name of his wife. The mortgagee then brought an action to set aside the tax deed and to foreclose the mortgage. The Court, in finding for the plaintiff, said in part:

"It is clear that a mortgagor cannot, by his negligence or fraud, suffer the mortgaged lands to be sold for taxes, and then, by purchase at the tax sale, or, after forfeiture, from the Sinking Fund Commission, acquire a title which he may set up to defeat the mortgagee's lien on said property. A court of equity could not tolerate this. What cannot be done directly, will not be permitted to be done indirectly. Therefore, a court of equity could not permit the wife of the mortgagor, or any other person, to acquire such a title to the detriment of the mortgagee, as the result of a deliberate scheme between the purchaser and the mortgagor to defeat the lien of the mortgage. Such conduct would estop the purchaser from asserting such title against the mortgage lien."

It thus clearly appears from the above that the rule operates not only against a purchase by the mortgagor at the tax sale, but also against a subsequent acquisition of such title directly or through mesne conveyances from a third person who purchased thereat, even though such title would have

26. 134 A. L. R. 292.

27. 134 A. L. R. 294, 296, and cases cited.

28. 134 A. L. R. 298.

29. 50 S. C. 459, 27 S. E. 948 (1897).

been good in the hands of such person. This rule is generally accepted in all jurisdictions.³⁰

It appears, therefore, that South Carolina, though the questions herein discussed have not often arisen for determination here, has followed the general rules and weight of authority whenever such questions have arisen, except perhaps as to the effect on the mortgage debt when the tax title and the mortgage lien meet in the same person. As to that, as stated above, the cases are fairly evenly divided.

Attention should be called to several statutes which, to greater or less extent, protect a mortgagee from losing his lien by means of a tax sale.

Section 2573³¹ requires the sheriff, before proceeding to advertise property levied upon for taxes for sale, to give twenty days written notice to all holders of mortgages on such property who shall list such mortgage, as to which notice is desired, with the clerk of court of the county in which the land lies on or before the fifteenth day of March of each year. This section further provides that unless such notice is given and other provisions are complied with by the sheriff and the clerk of court, the rights of mortgagees complying with the statute will not be affected. Mortgagees not so complying are protected to the extent of any right or remedy existing independently of this statute.

Section 2775³² provides, among other things, that upon application, at any time before sale under tax execution, of any mortgagee of property which is assessed for taxation, the county auditor shall apportion the share due by the owner upon the portion or interest mortgaged. The tax collecting officer is then directed to receive from the mortgagee the proportionate share of taxes upon such part or interest mortgaged and to give a receipt therefor, which receipt shall discharge such portion or interest mortgaged from all taxes and costs assessed against the owner. This right exists after the property has been advertised for sale under tax execution, provided the mortgagee also pays the *pro rata* cost of the advertisement, and the sale shall continue as to the remaining property.

30. 134 A. L. R. 302, and cases cited.

31. Code of Laws of South Carolina, 1942.

32. *Ibid.*

Section 2820³³ requires the sheriff conducting a tax sale to wait until the expiration of twelve months from the day of sale before executing his deed to the purchaser at such sale. During this twelve months, the owner, grantee, mortgagee, or judgment creditor of such land may redeem from the sale by paying to the sheriff the taxes, penalties, costs and expenses of the sale, together with seven per cent interest on the purchase price paid by the bidder, and all amounts paid by the bidder as taxes on said property. Such amount paid to redeem is added to the mortgage debt or other lien, with the same incidents as to priority, with the same rate of interest, and collectible in the same way as the original mortgage or judgment debt. The sheriff is required to give not less than thirty days' notice, before making title to the purchaser at the tax sale, to any mortgagee or assignee of any mortgage appearing of record within ten years of such seizure in order that such mortgagee or assignee may have opportunity to redeem. In the event the land is not redeemed, the sheriff is directed, upon written notice given or information obtained from the records, to hold any excess over taxes and costs for the benefit of mortgage or lien creditors according to priority, until authorized or directed by proper judicial authority as to the proper mode of disposition, or by the written consent of the defaulting taxpayer that the excess be paid over to such mortgage or lien creditors.

33. *Ibid.*