Tax Proration and Payment Tips When Buying and Selling Real Property

On behalf of Dornish Law Offices, PC | Apr 5, 2016 | All, News, Real Estate Practice

By Bradley S. Dornish, Esquire

Last month, I was contacted by a seller who sold his home last August. He had been trying for months to figure out why he paid 2015/2016 school taxes through his tax escrow, paid more 2015/2016 school taxes at closing, and never got his money back. He thought when he came to me that the settlement company (not my settlement company) had cheated him on his tax proration, the division of the tax bill between buyer and seller.

I reviewed his Settlement Sheet from closing, fortunately an old form HUD-1, since the new TRID forms, the closing disclosures, are in separate parts for buyers and sellers, making the review harder, but not impossible. I saw that the settlement company for an August closing had properly asked for the school tax bills from the municipal tax collection agency, which happened to be Jordan Tax Service, and that Jordan in mid- July had reported the new tax bill amount, which it had just received, that the tax was unpaid, and that this remained true until shortly before closing.

The settlement company charged the seller for the full school tax bill on the second page of the HUD, and then had the buyer reimburse the seller for the portion of the tax which applied from the date of closing to June 30th of 2016, being all but about six weeks of the tax, in the section marked items paid by seller in advance. The settlement company sent its check for the full 2015/2016 school taxes, almost $3,500.00, which was received by Jordan Tax Service and deposited to the benefit of the school district, with the reference for the buyer of the property.

However, the seller's lender had an escrow for taxes, and several days before closing, the escrow agent had sent an electronic funds transfer of the same amount, almost $3,500.00, from the seller's money held in escrow. Thus, the school taxes had been paid twice for the property for the 2015/2016 school tax year. The school district saw on its records in

September, that taxes had been paid twice, and also saw that the new buyer was the record owner of the property. The district issued its check for the overpayment to the buyer, with a letter explaining that the taxes had been overpaid, and the buyer happily cashed the check, and likely spent the money on items for his new home.

It took great cooperation from Jordan Tax and the school district to figure out what happened, and when the buyer understood that the refund he received belonged to the seller, he wrote another check to the school district, which finally issued a refund check to the seller late last month, over six months after closing.

Two buyers of property who closed (through my settlement company) early last July recently called and e-mailed us that they had received notices that their 2015/2016 school taxes were not paid, but they saw the proration on their settlement sheets, so something must not have been paid by the settlement company from closing. I pulled electronic copies of their HUD-1s, and saw exactly what had happened.

The school tax bills for the districts in which they bought property had not yet been determined by the districts or sent out in early July. There were no tax escrows, as one of the buyers paid cash, and the other bought with a loan which did not require a real estate tax escrow. We properly estimated the seller's portion of unpaid school tax based on the prior year's taxes for that property, charged each of the sellers and credited each of the buyers for a few days of school tax for the period from July 1 to the date of closing. We also had each buyer sign a form provided by the title company for which we are agents, which indicated that the tax bills hadn't come out, the seller had been charged a prorated share of school tax for the new tax period based on the last year's bill, and that the proration amount collected from the seller was final even if the tax bill went up.

Since two people in similar situations must not have understood the form they signed about taxes at closing, I rewrote the form to make it clearer.

I can explain in more depth in this article: When the tax bill isn't out for school taxes in July or even into August, or for municipal and/or county real estate taxes in January or even February, the settlement company can only use its best approximation of the tax bill for the new tax year in prorating taxes, which is the bill for the prior year. If the new tax bill is not yet out, we can't pay the bill, so we charge the seller his or her portion based on the prior year, and credit that amount to the buyer. That means the buyer will owe the whole tax bill for the new tax year when the bill comes out, and should be looking for a bill to pay if the money is not in escrow. Most municipal and county tax bills come out and are due sometime in the first quarter, as are Pittsburgh, Philadelphia and Scranton school tax bills. If you have no escrow, and you don't get a bill after you buy the property, ask for it quickly. Nobody else is going to pay your real estate taxes. If the bill goes to someone else after the deed is recorded in your name, and you miss paying the tax on time, most taxing bodies can and will waive penalties and interest, and collect the tax at face value only. Ask them to do that if you are late.

If you have an escrow set up when you buy a property, and the tax bills have not been finalized and sent out by the time you close, know that the escrow has been set up based on an estimated tax bill. When the escrow company gets the actual tax bill, if it went up from the prior year, they will pay the bill and it will result in a shortage in your escrow account. Usually, banks only analyze the escrow account once each year, so by the time the bank figures out you are short, you will owe the difference for both the present year and the next year. That means if your escrow account is short $120.00 for this year, your escrow payment will go up for a year by $20.00 each month, $10.00 for the current year shortage, and $10.00 to be sure the same problem isn't happening with your escrow for the next year.

When you sell a property and you have an escrow account for taxes, make sure you know what tax bills are due around the time you are closing, and make sure the escrow agent for your lender is not in the process of paying the same taxes the settlement company is collecting from you at closing. You should get a copy of your payoff letter to see if the escrow balance is being subtracted from the payoff, or being reimbursed to you by the lender after closing. Typically, if it being reimbursed, you should get your reimbursement check within 30 to 45 days after closing.

When you sell a property on which you don't have an escrow account for taxes, don't pay tax bills after the date you have a signed agreement of sale by mail. Of course you should pay those bills as they are due, at discount if you can, but PAY THEM IN PERSON at the tax collector's office, and get a paid receipt which you can provide to the settlement company before closing. This avoids the settlement company collecting for a tax you know you paid, but the tax collector has not processed before closing.

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April 2016