

11-1932

Tax Delinquencies and Municipal Bonds

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Recommended Citation

Batchelor, Thomas C. (1932) "Tax Delinquencies and Municipal Bonds," *Indiana Law Journal*: Vol. 8 : Iss. 2 , Article 3.

Available at: <https://www.repository.law.indiana.edu/ilj/vol8/iss2/3>

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COMMENTS

TAX DELINQUENCIES AND MUNICIPAL BONDS.

The growing and alarming increases in tax delinquencies coupled with the present tendencies of legislatures to restrict tax rates and grant tax moratoriums of various kinds places the holder of municipal and quasi-municipal bonds in a position of considerable wonderment as to the safety of his investment.

The present situation in regard to restricted income of governmental units causes a disturbing uncertainty concerning this type of security, long regarded as the safest type of conservative investment. It is even predicted by the pessimistic that defaults in municipal obligations, akin to the very general wholesale defaults in real estate bonds, may not be unexpected.

As to the effect of legislative acts on bonds already issued, there can be no real cause for concern. Acts designed to restrict the tax rates and effect moratoriums must stop short when they reach the point of interfering with the contract of the bond holder. Such acts will quickly be held to be unconstitutional as impairing the obligations of a contract. New issues, however, must be subject to this legislation and the purchaser will be charged with the knowledge and effect of all the statutes which affect the payment of his bonds.

It is the other problem—that of tax delinquencies—which has a more serious aspect. Before discussing the situation which may arise from failure to collect taxes, however, a distinction between bonds payable from special assessments and those which are the direct obligation of the municipality, or special taxing district, should be pointed out.

Bonds payable only out of special assessments, usually charged against the benefited or abutting property, and commonly known as improvement bonds, present no direct obligation on the part of the municipality. The municipality frequently stands in the position of trustee for the bond holders and is liable as such for its failure to collect and apply the assessments. It has been held, however, that it is not liable merely because the assessments are returned delinquent.

There is usually a variety of remedies available to the holder of this type of bond. McQuillin¹ lists these generally as follows:

1. Mandamus or mandatory injunction to compel collection and payment over of the special assessment.
2. Action at law against the municipality where it has neglected its duty and failed to perfect the assessment.
3. Action to recover judgment thereon against the municipality to establish and perpetuate the bonds as a claim upon the funds to be raised under the statute, and to prevent the bar of the statute of limitations.
4. Action at law if special assessment has been collected to recover on bonds up to amount collected.
5. Suit in equity for accounting, or the like, where there is actual or threatened diversion.
6. Under some statutes, the right to enforce a lien on abutting or benefited property.

It is the other type of security, the direct obligation of the municipality or taxing district, that fixes attention on the payment of taxes. A grant of the power to issue bonds is usually accompanied by statutory authority to levy taxes to pay the interest and principal on such bonds; where such authority is not especially granted it may be implied. In this type of security the financial integrity of the municipality, or taxing district has been regarded as affording the bond holder his greatest security. Assuming that such financial integrity is affected by large tax delinquencies, does it naturally follow that the bond holders' security is likewise affected?

Due to the fact that most municipal bond defaults have resulted from illegality of the issue, or invalidity of some part of the proceedings, the decisions on this particular question are not numerous. There are, in fact, a number of states where there have been no bond defaults. At first appearance, it would seem that if the municipality levies a tax which, if collected, would be sufficient to discharge its obligation, it has performed its duty; provided, of course, that the municipality follows up such levy with appropriate action against delinquent taxpayers. Indeed, various authorities on municipal law, and quite a few

¹ McQuillin, *Municipal Corporations* (2nd Ed.), Vol. 6, Ch. 43, Sec. 2428, pp. 113, 117 (1928).

state decisions, incline to this view: that tax delinquencies are the misfortune of the bond holders where the governmental agencies have levied the maximum tax possible under the statutes and constitution, and made diligent efforts to collect the same. This is particularly true where the bonds are payable only from a special tax levy, and not directly by the municipality.

But there is a contrary doctrine in the Federal Court, a doctrine that may or may not be more generally applied as tax delinquencies continue to increase. In the security which it offers to the bondholder, and the tremendous burden to which it subjects the faithful taxpayer, this theory is as interesting as it is startling.

Described briefly, this doctrine asserts that not only may property be taxed to pay its proportionate share of the cost of an improvement, but that it may be taxed to make up the deficit occasioned by the tax delinquencies of other property similarly benefited.

In *Norris v. Montezuma Irrigation District*,² the position is boldly taken that the statutory obligation of a municipal or quasi-municipal corporation to pay its debt, or to fix a rate of levy necessary to provide funds to pay its debt, is not satisfied by an assessment and rate of levy sufficient to pay the debt if the taxes are collected. There must, the opinion holds, be a sufficient assessment and levy and *collection* of the taxes as levied actually to pay the debt.

The Montezuma Valley Irrigation district of Colorado issued bonds in the amount of \$805,000.00 to raise funds for the construction of an irrigation district. From funds derived from taxes levied against each benefited acre in the district, interest on these bonds was paid for a number of years.

Because of tax delinquencies, however, there was a default in the payment of interest due December 1, 1914, and the holders of the bonds obtained a judgment, and followed this up by a mandamus action to compel the county to levy an additional tax against the lands of the district sufficient to pay the judgment.

The situation in regard to the tax delinquencies had been further complicated by the fact that a statutory provision for the sale of the lands for delinquent taxes had proved ineffective. Purchasers failed to appear at the tax sales and the party in most instances was struck off to the county.

² (1918) 248 Fed. 369.

The defendants' resisted the mandamus action on the ground that a sufficient levy had been made to pay the district's debt and that a further levy could not be required because it would impose an unequal burden on the lands. The effect of a new levy, it was contended, would be to require the whole debt to be discharged by those who had paid their part of the prior levy. This contention was upheld by the trial court.

In reversing the trial court's decision, the Circuit Court of Appeals discussed fully the various statutory provisions as to the uniformity of assessments to pay the district's indebtedness and then concluded:

"* * * the statute is peremptory that the bonds and interest shall be paid, and the remaining provisions only indicate the source and mode of obtaining the funds. In order to give full force and effect to every portion of the statute there must not only be an assessment and levy, but the debt must be paid."

To carry the objection to a re-assessment to its logical conclusion, the court declared, would mean that the regular annual assessment would be excessive in part because of the certainty that some taxpayers would not pay before the obligations of the district became due.

"It is a common provision in the state constitutions and statutes that assessments or levies for taxation shall be uniform upon the same class of subjects or by value,"

the court stated.

"But such provisions are not violated, when, after the lapse of a reasonable time, and after reasonable efforts have been made to collect the first levy, an additional levy is made upon all the property in the district because of the failure of some of the taxpayers to pay their portions of the first levy."

In support of its decision and as a particularly lucid exposition of this theory of taxation to discharge a municipal debt, the Court quoted from *State ex rel. Soutter v. The Common Council of the City of Madison*.³

"Nor is it of any importance, in a legal point of view, that many of the citizens have contributed their full proportions of the money which should have been applied in payment of these debts, whilst others have refused, it matters not whether rightfully or wrongfully. It seems oppressive, and is, in some respects, no doubt, a great hardship, that those who are diligent

³ (1862) 15 Wis. 33, 38.

and prompt in the discharge of their obligations to the public should be compelled to suffer on account of the delinquencies of others, occasioned sometimes by the mistakes of the officers of the law, or, it may be, of the Legislature, but more frequently the fault of the delinquents themselves. It is an evil inseparable from every system of taxation, a subject always difficult and never free from vices and imperfections—a misfortune which must ever attend those who dwell in communities where any are unwilling to bear their just share of the public burdens. In such affairs, the taxpayers are, as it were, sureties for one another. What one gains by accident or fraud, the other must lose. No deductions are ever made from the public revenues for such causes. The deficiencies of one year must be made up the next, and diverted funds restored. If these inequalities, often inevitable, were to constitute an excuse for the nonpayment of taxes, public faith would be at an end, and government must cease. Who doubts, for instance, that under our present law, rigid and impartial as the Legislature has endeavored to make it, great injustice is frequently done? That some are charged beyond their due proportion, whilst very many fall far short of it? So long as men suppress truth, and make false and corrupt statements of the amount and value of their property, and so long as mistakes occur; so long these things will continue. But the remedy does not consist in a refusal to pay all taxes. The evils, so far as possible, are to be obviated by the rigid enforcement of the law, the punishment of those who transgress its provisions, and the election of faithful and competent officers. Clearly such grievances, however perplexing and burdensome, are nothing to the public creditor, who has the right to look to the whole people for the payment of his demand. The duty of the common council is continuing, and does not cease with the levying of one tax which is in part unsuccessful. It ends only when the whole money is collected and the debt actually paid. They cannot, therefore, say that their powers are exhausted and no new tax can be levied.”

Equally interesting and well reasoned is the minority opinion voiced by Judge Amidon in *Norris v. Montezuma Valley Irrigation District*.⁴

“The scheme of the statute,” he said, “does not contemplate that one piece of land shall be responsible for the default of another in the payment of special assessments which the law authorizes * * *. It is manifest that under the majority opinion a faithful remnant of the property embraced in the project may be charged with substantially the entire cost of the irrigation project. That in my judgment is a clear departure from the scheme of the statute, and even if such were the scheme when properly construed, the result would be a violation of both the state and the federal constitution.”

These widely divergent views will become increasingly important if present conditions continue, and it will be interest-

⁴ See note 2, *supra*.

ing to watch the trend of decisions as simultaneous efforts are made both to relieve the taxpayer and to protect the anxious bondholder.

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