

A Reprint from *Tierra Grande*

# Transfer Fees

## MORE THAN YOU BARGAINED FOR

By Judon Fambrough and Harold D. Hunt

A Texas couple decided to take advantage of the federal tax credit for first-time homebuyers, and placed a contract on a \$200,000 home in a subdivision. While reviewing the title commitment two weeks before closing, they discovered the residence is subject to a deed restriction requiring them and all future buyers to pay a 1 percent “transfer fee” on the sales price to the property owners’ association (POA) each time the property sells.

The couple has never heard of a transfer fee. They immediately want to know if such a fee is enforceable. They wonder why they were not told about the fee before entering into the contract. More importantly, can they get out of the contract because they were not told earlier?

### What Texas Law Says

In 2007, the Texas legislature passed HB 2207, adding Section 5.017 to the Property Code. On a statewide basis, the law prohibits transferees (buyers) from paying a transfer fee when acquiring residential property. The prohibition does not affect commercial property. The rule applies only to transactions that occur or contracts entered into on or after Jan. 1, 2008.

Exceptions to the statewide rule exist for residential property located in subdivisions. Here, the fee is permitted when payable to a property owners association (POA) when the subdivision has at least one platted lot, an entity organized under Section 501(c)(3) of the Internal Revenue Code, or a governmental entity. The fee may be paid by anyone, including the buyer.

Under either the statewide or the subdivision rule, the deed restriction or covenant requiring the payment must run with the land. Basically, this means the restrictions or covenants bind those who purchase the land with notice of the restriction. Only the owner of the land may place an enforceable restriction on the property.

The couple realizes that the transfer fee in this case is enforceable because the contract was entered after the effective date of the statute and the subdivision rules apply. Consequently, they begin searching for ways to void (rescind) the contract.

Aside from how the fees affect future sales prices, the statute raises several legal questions.

Could the transfer fee in a subdivision serve as a substitute for or a supplement to an impact fee? Because the fee is enforceable when payable

to a governmental entity, could the city condition the approval of a subdivision plat based on a fee payable to the city? If so, would such a fee be subject to the statutory requirements and limitations placed on impact fees (Chapter 395 of the Local Government Code)?

Is the receipt of the fee assignable? Could a POA raise capital by assigning the right to receive the fees to a bank or another entity such as an investment bank?

What mechanism exists to determine if the fees have been paid? Would or could the POAs, cities and governmental entities render a certificate verifying receipt of payments? Would or could the payment of the transfer fee payable to the POA be reflected in the Resale Certificate issued when required by Section 207.003 of the Property Code?

Would a transfer fee payable to a 501(c)(3) organization be tax deductible as a charitable contribution on the buyer’s income taxes? What would happen if the recipient lost its 501(c)(3) status? Would this terminate the transfer fee, or could it be switched to another entity that still maintains its 501(c)(3) status? If so, who would make the decision?

Are there any limitations on the amount or number of transfer fees that can be placed on residential property? The proponent of the fee, a company called Freehold Licensing, developed a covenant requiring the payment of 1 percent of the sales price whenever the property is sold. In some cases, 30 percent goes to Freehold Licensing for developing the covenant, 10 percent goes to the broker, and 60 percent to the original owner who places the restriction on the property.

If this plan were enacted, the broker in this scenario could be placing his or her license in jeopardy. The broker must answer two questions. First, would this fee represent an actual or expected fee, commission or other remuneration for which a real estate license is required? If so, this would constitute dividing a commission with a nonbroker, which is prohibited by the Real Estate Licensing Act (Section 1101.652[11] of the Texas Occupations Code).

Currently, the statewide rule mandates that “. . . a transfer fee that requires a *transferee* (a buyer) of residential real property or the *transferee's heirs, successors, or assigns* to pay a declarant or other person . . . a fee in connection with a future transfer of the property is prohibited.”

This raises more questions.

First, the statewide rule does not prohibit a transfer fee that is payable by the *transferor* (the seller). But the statewide rule prohibits the buyer from paying the fee. Why the difference?

Second, is the statewide rule a one-time payment that is not binding on future transactions? The statutory language prohibits the transferee, his or her heirs, successors or assigns from paying the fee. Taken literally, this language prohibits anyone who takes the property from the immediate buyer, such as the buyer's heirs, successors or assigns, from ever having to pay the fee.

Legally speaking, *to assign* means *to transfer*. An assignee is someone who receives property from another. So anyone purchasing the property from the present owner is an assign (or assignee) and is prohibited by law from paying the transferee fee.

How would this ambiguity be handled by title companies at closing? Would a judicial determination be necessary?

Third, how can the collection of the fee be enforced? Can a lien be placed on the property and foreclosed? The statute is silent on the issue except to say that under the statewide rule a lien purporting to encumber the property that violates Section 5.017 is void and unenforceable.

If the fee is not paid, would the statute of limitations expire four years after the sale or four years after discovery of the unpaid fee? That is, would the discovery rule apply in this situation?

What would happen to the funds if the title company cannot locate the payee of the fee 50 years from now? Would the funds revert to the state?

Finally, is there any way a buyer can get out of the contract once the transfer fee is discovered?

One possibility lies in Section 5.016 of the Property Code, passed simultaneously with Section 5.017 in 2007. It requires the seller to inform prospective residential buyers of any recorded lien that will encumber the property after closing.

The notice must be given seven days prior to entering a binding contract. Purchasers have seven days to terminate the contract after receiving the notice. Failure to give the notice does not invalidate a subsequent conveyance, though.

No notice of recorded liens is required, when among other things:

- the purchaser obtains a title insurance policy or
- the seller reasonably believes, and takes necessary action, to ensure the lien will be released within 30 days after the transfer.

In our example, the couple purchased title insurance, which is how they discovered the fee. Thus, Section 5.016 offers no relief.

Can the couple object to title under paragraph 6D of the promulgated forms

and avoid the contract? Probably not. Paragraph 6D allows objections to encumbrances to title disclosed in the title commitment. However, no objections are allowed for restrictive covenants common to the platted subdivision in which the property is located.

The couple can search the deed records to see if the transfer fee is common to all lots in the subdivision or just to a few. If only certain lots are subject, they may be permitted to file an objection under paragraph 6D.

Finally, under Texas case law, a covenant running with the land must meet four requirements. The covenant must:

- touch and concern the land,
- relate to a thing in existence or specifically bind the parties and their assigns,
- be intended to run with the land by the original parties who placed the covenant on the land, and

- require that notice of the covenant be given to the successors to the burden (subsequent owners).

The fourth element recited by the courts was never clarified. It is a timing issue. Must the successors to the burden have notice before entering the contract or before closing?

If the notice must be given before the contract, it appears the couple may be able to rescind the contract under the Deceptive Trade Practices Act (DTPA). In a case decided by the Texas Supreme Court in 1988, the seller failed to inform the buyers before entering the sales contract that the house was subject to demolition (*Ojeda de Toca v. Wise*). The buyers successfully sued the seller under the DTPA for failing to disclose even though the order was recorded in the deed records.

However, the failure to disclose a transfer fee on the property may not be grounds for a DTPA lawsuit.

Rescission is a viable remedy under the DTPA and may apply in this situation. For more information on this topic see the Center's publication entitled "The Way Out" <http://recenter.tamu.edu/pdf/1576.pdf>.

The law relating to transfer fees raises a multitude of legal questions. Future legislation and litigation will undoubtedly

raise even more. Five proposed bills were introduced and failed during the last legislative session. The next session will surely bring more.

This article is for information only. For specific legal advice, consult an attorney. ♣

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## THE TAKEAWAY

Texas law governing transfer fees raises more questions than it answers. Transfer fees are imposed by developers or other private entities and require a fee, often a specified percentage of the sale price, be paid to someone or some entity each time the property is sold. The future status of this law is uncertain.



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