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LAW OFFICES OF THOMAS W. KELLY

TEN BULL STREET • NEWPORT, RI 02840  
TEL: 401-846-1995 FAX: 401-846-1997

June 26, 1998

To: All City and Town Clerks

From: Attorney Thomas W. Kelly

Re: Unlawful acceleration of real property tax payments

Please place the attached letter on the docket for the next regularly scheduled meeting of the City/Town Council of your community and insure that it is distributed to all the elected officials in your community.

Please be kind enough to advise this office of receipt of this letter in writing and further advise me of what, if any, action your council takes with the letter.

Thank you for your cooperation.

Thank you for your cooperation.

IN CITY COUNCIL  
AUG 6 1998  
READ  
WHEREUPON IT IS ORDERED THAT  
THE SAME BE RECEIVED.  
*Richard J. Clement* CLERK

LAW OFFICES OF THOMAS W. KELLY  
TEN BULL STREET NEWPORT, RI 02840  
TEL: 401 - 846 - 1995 FAX: 401 - 846 - 1997 EMAIL: infotom@edgenet.net

June 27, 1998

To: All elected officials of the Cities and Towns in Rhode Island

Subject: (1) Unlawful acceleration of real property tax payments through federally regulated banks, and;

(2) *Tomaio, et al. vs. Newport, Barrington, Bristol, Coventry, Cumberland, Foster, Glocester, Jamestown, Lincoln, Middletown, Narragansett, North Smithfield, Pawtucket, Providence, West Greenwich, and West Warwick, United States District Court No. CA 98-141ML*

References: RIGL 44-5-7; the Real Estate Settlement Practices Act, 12 USC §2601, et seq.; Regulation X, 24 CFR 3500.17(k)

Dear Elected Officials:

The purpose of this letter is to inform all elected public officials in the municipal governments in Rhode Island of the case pending in the United States District Court for the District of Rhode Island that may effect many thousands of real property taxpayers in your communities as well as the municipalities themselves.

Most fundamentally, it involves the fundamental fairness due to all taxpayers in your community.

This litigation may have an impact on the municipal budgets in the cities and towns for the 1999 municipal fiscal year. Furthermore, the vast majority of the people affected have no knowledge of the fact their taxes are being paid to the cities and towns illegally and that they are being forced to bear an unfair percentage of the property tax burden in their respective communities.

#### BACKGROUND

Approximately 25% of real property taxes in Rhode Island are not paid by the taxpayers directly, but are paid through the banks that hold mortgages on the properties.

Prior to 1995, many banks escrowed and paid property taxes in full in the first quarter. This practice was known as "overescrowing." This practice protected the bank's loan and enhanced the bank's cash reserves. Simultaneously, it created a first quarter windfall for the municipalities.

The process was harshly criticized as unfair to the taxpayers. The Attorneys General of seven states submitted a report to Congress in 1990 that sought an end to the practice. The situation is well described in the April 25, 1990, article from *The New York Times* that is attached.

Although it took several years, the federal government did respond to the request for changes in escrow collection practices.

On October 29, 1994, the United States Department of Housing and Urban Development amended the provisions of "Regulation X" which governs the way that banks are allowed to collect and pay property taxes through escrow accounts. The amendments were effective in April, 1995. The applicable section of the current Regulation is also attached.

The federal regulations are authorized by the Real Estate Settlement Practices Act, commonly known as "RESPA."

In general, RESPA supersedes all state laws inconsistent with the Act. However, if state law provides *greater* protection to the taxpayer, then the state law is not preempted by the federal enactment.

The 1994 amendments to the Regulation X *prohibited* all federally regulated banks here from paying property taxes in full on an annual basis unless the taxing authority offered a discount. In Rhode Island, only the city of East Providence offers a discount. *Therefore, lump sum payments of real property taxes by federally regulated banks were unlawful from 1996 to the present everywhere in Rhode Island but East Providence.*

## THE PROBLEM IN RHODE ISLAND

Obviously, the loss of the first quarter windfall was not popular with the financial officers of the municipalities. However, it appears at least one major financial institution was determined to avoid the end of "overescrowing" in

Rhode Island by convincing the local tax officials to overstep their legal authority.

I now have very credible information that a representative of a wholly owned subsidiary of a Fortune 500 company approached literally every tax collector in Rhode Island in 1995 and induced them to attempt to avoid the impact of the changes to the Federal regulation by writing letters to the banks effected stating that *local* tax policy still **required** lump sum annual payments.

Based upon the information I have at this hour, approximately 15 communities bought into this scam and made at least some attempt to pressure the banks to continue paying in full in the first quarter. Those communities are now defendants in the suit pending in US District Court. Once the identity of the offending tax servicer is corroborated, it too will be made a defendant, as well as their officers and agents.

In fact, they had no legal authority do make such demands. Rhode Island law is clear on the subject of lump sum vs. annual payments. Title 44, Chapter 5 states:

"Every city and town shall make provision for the payment in installments of any tax levied under the provisions of 44-5-1 by adding to and making a part of the resolution ordering the assessment and the collection of the tax an option permitting persons assessed to **pay their taxes in equal quarterly installments if they so desire . . .**" RIGL 44-5-7(emphasis added)

Well advised as to the real intention of the changes in federal law, many banks simply ignored the demand for lump sum, first quarter payments. *However, many complied, and some are still escrowing taxes for payment in full in the first quarter of fiscal 1999!*

In January of this year, I wrote a lengthy complaint to Rhode Island Attorney General Jeffrey B. Pine advising him of the situation.

The Attorney General agreed with my interpretation of the law and wrote a letter to all of the tax officials of all the cities and towns advising them of his position and threatening litigation if the practice continued. A copy of the letter is also enclosed.

The lawsuit was filed shortly after the Attorney General issued his opinion. The lawsuit is premised on the theory that the acceleration of real property tax collections in violation of both state and federal law deprives the persons affected of the equal protection of the law and due process of law under the Fourteenth Amendment of the Constitution of the United States and makes the municipality and the offending officials liable for damages.

There are now 25 plaintiffs in the case and they are seeking certification as representatives of a class that may be as large as 40,000 people. Despite the pending lawsuit and the Attorney General's letter, I have learned from numerous clients and banks that there are still many large institutions that have overescrowed accounts and they intend to pay in full in the first quarter of 1999, i.e., on or about July 1, 1998.

For the foregoing reasons, I am placing you on notice that it is my position the mere acceptance of a check from any federally regulated bank paying real property taxes in full in the first quarter by any Rhode Island community (except East Providence), without the consent of the taxpayer, will give rise to a cause of action for deprivation for breach of civil rights under the Federal Civil Right Act.

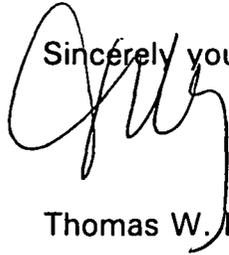
I believe the cities and towns are bound by law to return three quarters of any lump sum annual payments tendered by the banks to them for return to the taxpayer (or to the bank, if the bank advanced the funds as Regulation X requires). Failure to do so unfairly shifts the tax burden to the taxpayers whose taxes are paid through an escrow arrangement and violates federal and state law as well as the Fourteenth Amendment.

Research conducted thus far indicates that over \$100 million was paid over a 3 year period by approximately 40,000 taxpayers after the amendments to Regulation X. The net effect of these events was that these people paid a larger share of the property taxes in the community than persons who paid quarterly.

As elected officials, you are duty-bound to insure your constituents are afforded the equal protection of the law. I hope that you will see the manifest unfairness in these practices and take appropriate action to protect the citizens in your communities that are affected.

I have no authority whatsoever to order your appointed officials to act, but you do. I believe it is your obligation to insure that all the taxpayers in community are treated equally. Otherwise, you have been forewarned.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'TKelly', written over the printed text 'Sincerely yours,'.

Thomas W. Kelly, Esq.

Encl.

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# Own a New York Home? You May Be Due \$400

**A** couple's 13-year crusade for change in the mortgage business came to an end this week with new rules that will lead to refunds for millions of home buyers.

In 1981, Eugene and Frances Rogan of Merrick, L.I., began a letter-writing campaign after they discovered that their lender had tacked \$134 onto their monthly mortgage payments for escrow. The practice left the Rogans with escrow balances of \$1,000 or more at the end of each year — money that they could not retrieve and that earned interest for the lender.

Their complaints about the practice went nowhere for nearly a decade, but the Rogans persisted. Eventually, the New York Attorney Gen-

eral picked up the case and began working with other states. Under the Clinton Administration, the Department of Housing and Urban Development took up the matter.

## Clamping down on lenders' escrow practices.

Concluding that millions of homeowners have been routinely overcharged, the department issued regulations this week that prohibit lenders from accumulating unwarranted surpluses in borrowers' escrow accounts, which are used to insure prompt payment of such things as property taxes, homeowner's insurance and private mortgage insurance. Surpluses of four, six and even eight months' worth of payments have been common, the agency said. The new rules limit the lender's cushion to two months of payments.

Although escrow practices were covered under the Real Estate Settlement Procedures Act, the law was murky on the subject and real-life practices varied.

For all new loans and escrow accounts, lenders must comply with the new rules within six months. Lenders have three years, however, to return any excess money to existing borrowers, so homeowners should not expect a check in time to pay the holiday bills.

"Our conservative estimate is

that approximately \$1.5 billion will be returned to homeowners," said Nicholas Retsinas, an Assistant Secretary at the housing department.

Mel Goldberg, a New York Assistant Attorney General, said: "There are people, especially in states that have high taxes and high property values, who can see refunds of considerably more than the estimated \$150 average nationwide. In New York the average is more like \$400 per homeowner."

In addition to customer refunds, the rules should lower closing costs for many buyers. Mr. Retsinas pegged the average savings for new borrowers at \$250.

The rules require lenders to send homeowners an annual statement of escrow account activity and to refund money when the balance exceeds two months' payments by more than \$50. For underpaid escrow accounts, a payment schedule will be permitted.

Perhaps most important, the rules specify how monthly escrow bills will be calculated. Lenders are to simply divide the total tax and insurance bill for the year by 12 to reach a monthly payment. Eighty percent of mortgage lenders have calculated the cushion separately for each tax — like school, sewer and property tax — which did not take into account that the bills came due at different times and excessively padded accounts, the housing agency said.

Although some people have successfully pressed their lenders for escrow refunds and many class-action suits are pending, most people have routinely paid their escrow bills. After all, balking could mean risking foreclosure.

But there is another option. Home buyers may be able to set up their own tax and insurance account, keeping the interest it produces. When the Rogans refinanced their home to take advantage of low interest rates last year, they insisted on just such an arrangement.

Many state laws stipulate that home buyers who deposit 20 percent or more can establish their own escrow. Lenders do not like to let consumers do it themselves, though, and routinely refuse on smaller down payments.

"These reforms," said Chris Lewis of the Consumer Federation of America in Washington, "put a little muscle on the side of the consumer."

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### Q & A/Ma

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*NY Times 10/29/94*

We



State of Rhode Island and Providence Plantations

DEPARTMENT OF ATTORNEY GENERAL  
150 South Main Street, Providence, RI 02903  
(401) 274-4400

Jeffrey B. Pine, Attorney General

March 4, 1998

RECEIVED  
TOWN OF HARRISVILLE

MAR 5 1998

Mr. John P. Mainville  
TAX COLLECTOR  
Burrillville Town Hall  
105 Harrisville Main Street  
Harrisville, Rhode Island 02830

FINANCE DEPARTMENT

Re: Levy and Assessment of Local Taxes - Municipal  
Installment Payments

Dear Mr. Mainville:

I have received an allegation that certain cities and towns may engage in tax collection practices in contravention of R.I. Gen. Laws §44-5-7, provision for municipal installment payments, and Regulation X, Escrow Accounting Procedure, Real Estate Settlement Procedures Act (26 USC § 2610, et. seq.). In order to give guidance on these laws and to encourage voluntary compliance, I am writing to all cities and towns in Rhode Island. In short, a municipality's requirement that tax payments be made in the first quarter, on an annual basis or other prepayment basis is unlawful for the reasons stated below.

Every city and town shall allow installment payments for any levied tax (see R.I. Gen. Laws §44-5-7). Relative to property taxes, lending institutions often establish an escrow account to ensure the payment of real estate taxes. In that regard, federal law governs the lender's practice, specifically a rule known as Regulation X. Regulation X does not allow a lender to pay installment payments on an annual or other prepayment basis unless there is a discount to the borrower for early payments.

I ask that you review your municipality's practice in connection with these and related state and federal laws. Upon receipt of information that a city or town continues a tax collection practice that violates the foregoing statutes, the Department may file a civil action to enjoin the practice.

Very truly yours,

Jeffrey B. Pine  
Attorney General

**44-5-5. Determination of date on which taxes due — Penalties on delinquencies.** — The electors in a financial town meeting of any town qualified to vote on any proposition to impose a tax or for the expenditure of money, or the city council of a city, shall determine the date on which taxes shall be due and payable and the date on which they shall be subject to a penalty, unless otherwise provided by law, and all taxes remaining unpaid on the date specified shall carry until collected a penalty at a rate determined by the electors or city council.

**History of Section.**

G.L. 1938, ch. 31, § 1; P.L. 1949, ch. 2330, § 2; G.L. 1956, § 44-5-5.

**Reenactments.** The 1988 Reenactment (P.L. 1988, ch. 84, § 1) inserted "a" preceding "financial town" near the beginning of the section, and substituted "the" for "said" near the end of the section.

**Collateral References.** Contest in good faith of validity of tax as affecting liability to penalty for failure to pay tax, 147 A.L.R. 142.

Disallowance of claims for "penalties" under 11 US Code § 93(j), 1 A.L.R. Fed. 657.

Doubt as to liability for, or as to person to whom to pay, tax, as affecting liability for penalties and interest, 137 A.L.R. 306.

Executor, administrator, or trustee, penal-

ties or interest incurred by, as a charge against him personally or against the estate, 47 A.L.R.3d 507.

Judgment for taxes, provision in, as regards future penalties, 93 A.L.R. 793.

Notice to taxpayer, lack of, as affecting penalty for nonpayment of taxes when due, 102 A.L.R. 405.

Time of mailing or receipt as determinative of liability for penalty or additional amount for failure to pay tax within prescribed time, 158 A.L.R. 370.

What is "last known address" of taxpayer for purposes of mailing of notice of tax deficiency under § 6212(b) of the Internal Revenue Code of 1954 (26 USCS § 6212(b)), 58 A.L.R. Fed. 548.

**44-5-6. [Repealed.]**

**Repealed Sections.** This section (G.L., ch. 57, § 11; P.L. 1912, ch. 769, § 41; G.L. 1923, ch. 59, § 11; G.L. 1938, ch. 30, § 11; G.L. 1956, § 44-5-6; P.L. 1960, ch. 52, § 29 (unconstit.); P.L. 1961, ch. 3, § 1) was repealed by P.L. 1969, ch. 197, art. 7, § 13.

**44-5-7. Provision for municipal installment payments.** — Every city and town shall make provision for the payment in installments of any tax levied under the provisions of § 44-5-1 by adding to and making a part of the resolution ordering the assessment and the collection of the tax an option permitting persons assessed to pay their taxes in equal quarterly installments if they so desire, the amounts and dates for payment of the installments to be specified in the resolution; provided, however, that the city or town may provide that the option contained in the resolution shall not apply to any tax levied in an amount not in excess of fifty dollars (\$50) in which case the tax shall be payable in a single installment.

**History of Section.**

P.L. 1934, ch. 2101, § 1; G.L. 1938, ch. 36, § 2; G.L. 1956, § 44-5-7; P.L. 1969, ch. 224, § 1; P.L. 1986, ch. 109, § 1.

**Reenactments.** The 1988 Reenactment (P.L. 1988, ch. 84, § 1) substituted "the" for the words "such" and "any such" throughout the section.

**Collateral References.** Failure of property owner to make formal election to avail himself of privilege of paying taxes in installments, 140 A.L.R. 1442.

Installments, constitutionality of statute permitting payment of taxes in, 101 A.L.R. 1335.

**44-5-8. Form of option for quarterly payments.** — The option shall be expressed in substantially the following form:

"The tax may be paid in \_\_\_ installments, the first installment of \_\_\_ percent on or before the \_\_\_ day of \_\_\_ A.D. 19\_\_\_: (proportions and dates to be specified.)"

"Each installment of taxes if paid on or before the last day of each installment period successively and in order shall be free from any charge for interest."

"If the first installment or any succeeding installment of taxes is not paid by the last date of the respective installment period or periods as they occur then the whole tax or remaining unpaid balance of the tax as the case may be shall immediately become due and payable and shall carry until collected a penalty at the rate of \_\_\_ percent (not less than six (6) nor more than eighteen (18) or, in the case of the city of Cranston, not more than twelve (12) per annum); provided, however, that taxes payable to the city of Newport, the town of Middletown, the town of Hopkinton, the town of West Greenwich, and the town of North Kingstown shall bear interest on any unpaid quarterly payments, and that only the unpaid quarterly payments shall be due and payable to the city of Newport, the town of Middletown, the town of Hopkinton, the town of West Greenwich, and the town of North Kingstown notwithstanding the provisions of this section to the contrary."

**History of Section.**

P.L. 1934, ch. 2101, § 1; P.L. 1936, ch. 2373, § 1; G.L. 1938, ch. 36, § 2; G.L. 1956, § 44-5-8; P.L. 1970, ch. 257, § 1; P.L. 1972, ch. 5, § 1; P.L. 1980, ch. 137, § 1; P.L. 1982, ch. 143, § 2; P.L. 1982, ch. 343, § 2; P.L. 1985, ch. 35, § 1; P.L. 1985, ch. 36, § 1; P.L. 1985, ch. 208, § 1.

**Reenactments.** The 1988 Reenactment (P.L. 1988, ch. 84, § 1) substituted "the" for the words "such" and "said" near the begin-

ning of the section, and made several minor stylistic changes throughout the section.

**Compiler's Notes.** This section was amended by three Acts (P.L. 1985, ch. 35, § 1; P.L. 1985, ch. 36, § 1; P.L. 1985, ch. 208, § 1) passed by the 1985 General Assembly. Inasmuch as the last Act contains the amendments made by the prior two Acts, the section is set forth above as amended by P.L. 1985, ch. 208, § 1.

**44-5-9. Deductions and penalties to insure prompt payment.** — Any town may provide for such deduction from the tax assessed against any person, if paid by an appointed time, or for such penalties by way of percentage on a tax, if not paid at the time appointed, not exceeding eighteen percent (18%) per annum, as it shall deem necessary to insure punctual payment; provided, however, that the city of Cranston may charge a penalty not exceeding twelve percent (12%) per annum.

**History of Section.**

G.L. 1896, ch. 50, § 1; G.L. 1909, ch. 62, § 1; G.L. 1923, ch. 64, § 1; G.L. 1938, ch. 36, § 1; G.L. 1956, § 44-5-9; P.L. 1982, ch. 143, § 2; P.L. 1982, ch. 343, § 2.

**Reenactments.** The 1988 Reenactment (P.L. 1988, ch. 84, § 1) substituted "it" for "they" near the middle of the section.

for the escrow item and comply with any other requirements of paragraph (k) of this section. The servicer must use the escrow account analysis to determine whether a surplus, shortage, or deficiency exists, and must make any adjustments to the account pursuant to paragraph (f) of this section. Upon completing an escrow account analysis, the servicer must prepare and submit an annual escrow account statement to the borrower, as set forth in paragraph (i) of this section.

\* \* \* \* \*

(f) \* \* \*

(2) \* \* \*

(iii) After an initial or annual escrow analysis has been performed, the servicer and the borrower may enter into a voluntary agreement for the forthcoming escrow accounting year for the borrower to deposit funds into the escrow account for that year greater than the limits established under paragraph (c) of this section. Such an agreement shall cover only one escrow accounting year, but a new voluntary agreement may be entered into after the next escrow analysis is performed. The voluntary agreement may not alter how surpluses are to be treated when the next escrow analysis is performed at the end of the escrow accounting year covered by the voluntary agreement.

\* \* \* \* \*

(i) \* \* \*

(1) \* \* \* The annual escrow account statement must include, at a minimum, the following (the items in paragraphs (i)(1)(i) through (i)(1)(iv) must be clearly itemized):

\* \* \* \* \*

(iv) The total amount paid out of the escrow account during the same period for taxes, insurance premiums, and other charges (as separately identified);

\* \* \* \* \*

(k) Timely payments. (1) If the terms of any federally related mortgage loan require the borrower to make payments to an escrow account, the servicer must pay the disbursements in a timely manner, that is, on or before the deadline to avoid a penalty, as long as the borrower's payment is not more than 30 days overdue.

(2) The servicer must advance funds to make disbursements in a timely manner as long as the borrower's payment is not more than 30 days overdue. Upon advancing funds to pay a disbursement, the servicer may seek repayment from the borrower for the deficiency pursuant to paragraph (f) of this section.

(3) For the payment of property taxes from the escrow account, if a taxing jurisdiction offers a servicer a choice between annual and installment disbursements, the servicer must also comply with this paragraph (k)(3). If the taxing jurisdiction neither offers a discount for disbursements on a lump sum annual basis nor imposes any additional charge or fee for installment disbursements, the servicer must make disbursements on an installment basis. If, however, the taxing jurisdiction offers a discount for disbursements on a lump sum annual basis or imposes any additional charge or fee for installment disbursements, the servicer may at the servicer's discretion (but is not required by RESPA to), make lump sum annual disbursements in order to take advantage of the discount for the borrower or avoid the additional charge or fee for installments, as long as such method of disbursement complies with paragraphs (k)(1) and (k)(2) of this section. HUD encourages, but does not require, the servicer to follow the preference of the borrower, if such preference is known to the servicer.

(4) Notwithstanding paragraph (k)(3) of this section, a servicer and borrower may mutually agree, on an individual case basis, to a different disbursement basis (installment or annual) or disbursement