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Code to Code

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Hope for Redemption

The Treatment of Pre-Petition Tax Sales in Bankruptcy

Many states' laws provide for the collection of unpaid property taxes through tax sales of property. While state statutory tax sale schemes differ, a common attribute is that the purchaser of an unpaid property tax claim can obtain a title to the property against which the taxes were levied. Following a tax sale, a property owner is typically granted some period of time to redeem the property that has been sold. When a taxpayer commences a bankruptcy between the time of the sale and the foreclosure of the right of redemption, bankruptcy courts are called upon to determine the rights of the debtor taxpayer and the tax sale purchaser.

This determination depends on fundamental questions, including the nature of property rights and claims. Recent decisions have characterized debtors' tax sale redemption rights as estate property, and the right of a tax sale purchaser to receive a payment upon redemption as a claim, but these conclusions are not unanimously accepted.¹ If a tax sale purchaser's entitlement to a redemption payment is not a claim as defined by 11 U.S.C. § 101(5), then debtors may not have the ability to redeem properties lost at a pre-petition tax sale through payments extending over the term of a plan.

There have been markedly disparate results concerning these issues across the nation and even within judicial districts. While the outcome of a bankruptcy debtor's effort to exercise rights of redemption through a plan is unpredictable, the outcome generally depends on two central questions: (1) whether the property sold at tax sale, or only the right to redeem that property, becomes property of a debtor's bankruptcy estate; and (2) whether a tax sale purchaser's right to receive payment upon redemption is a "claim." The questions are related, and are answerable only by understanding the par-

ticular rights acquired by a purchaser and lost by a property owner through a tax sale.

What Becomes Property of the Estate: The Property or the Right to Redeem It?

To determine whether it is permissible to adjust the relationship between a debtor and a tax sale purchaser in bankruptcy, it is necessary to determine the nature of the relationship under non-bankruptcy law.² In some jurisdictions, tax sale purchasers acquire a lien on a taxpayer's property; in others, purchasers acquire the title to the property itself.³ This title is typically defeasible in that it terminates upon the taxpayer's payment of the redemption price, usually comprised of back taxes, interest and costs.

If a tax sale purchaser acquires a lien at a tax sale with respect to a property, then the fee title to the property remains with the taxpayer/debtor and becomes property of the estate.⁴ If a purchaser acquires the title to the property, then it is possible that only the right of redemption becomes property of the bankruptcy estate.⁵ The distinction is simple to state but difficult to apply, because tax sales result in an unbundling of rights that, in combination, are imprecisely referred to as ownership.⁶

In *In re Edwards*, the court considered a tax sale purchaser's motion for relief from stay to fore-



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¹ See *Encore Assets LLC v. Woodley (In re Woodley)*, 579 B.R. 630, 633 (Bankr. N.D. Ga. 2017) (compiling cases).

² *In re Gonzales*, 550 B.R. 711, 715 (Bankr. E.D. Pa. 2016).

³ *Compare Harlan v. Neb. All. Reality Co. (In re Harlan)*, 16-bk-7769-RLM-13, 2017 Bankr. LEXIS 3640 (Bankr. S.D. Ind. Oct. 19, 2017) (under Indiana law, tax sale purchase acquires certificate that constitutes lien), with *In re Pitman*, 549 B.R. 614, 621-22 (Bankr. E.D. Pa. 2016) (under Pennsylvania law, tax sale purchaser acquires inchoate defeasible title to property purchased).

⁴ *Harvest Assets LLC v. Edwards (In re Edwards)*, 14-bk-51366-CRM, 2014 Bankr. LEXIS 5432, at *6-8 (Bankr. N.D. Ga. Nov. 13, 2014).

⁵ *In re Woodley*, 579 B.R. at 633.

⁶ *Compare In re Edwards*, 2014 Bankr. LEXIS 5432, at *6 ("Because the record owner no longer has title to the tax sale property, it does not become part of the bankruptcy."), with *In re Woodley*, 579 B.R. at 636 ("[I]f a debtor's redemption rights never terminated, [the] Debtor remains the owner of the Property. The Property, therefore, is property of [the] Debtor's bankruptcy estate.")

close a debtor's right of redemption under Georgia law.⁷ The debtor's home was sold at a tax sale pre-petition, and the statutory redemption period was set to expire post-petition.⁸ The debtor objected to the purchaser's motion for relief from stay citing his confirmed plan, which provided for the payment of the redemption amount over the life of the plan.⁹ In granting the relief from stay, the court reasoned that "[w]hile the Debtor's right to redeem became property of the estate upon filing ... the property is not property of the estate. [The] Debtor's chapter 13 plan cannot bind ... the [tax sale purchaser] to a plan provision disposing of its property rights when such property is not within the Court's vested jurisdiction."¹⁰

Conversely, in *In re Woodley*, the court allowed a chapter 13 debtor to pay the \$20,800 redemption price resulting from a pre-petition tax sale over the life of a chapter 13 plan.¹¹ As in *Edwards*, Georgia's one-year redemption was set to expire post-petition.¹² The debtor proposed to treat the redemption price as a secured claim paid by way of monthly installments.¹³ The tax sale purchaser objected to the confirmation of the debtor's plan, arguing that the plan resulted in an impermissible compelled sale of the property back to the debtor.¹⁴

In analyzing the property interests that became property of the estate, the court acknowledged its disagreement with *Edwards*, among other decisions, and characterized the question as a close one.¹⁵ The court noted that the *Edwards* conclusion — that only the right of redemption became property of a bankruptcy estate — did not fully account for the other rights retained by a property owner following a tax sale under Georgia law, such as the rights of exclusive possession, use and profits.¹⁶ The court cited a decision of the Supreme Court of Georgia, which held that a taxpayer's title is not fully divested until the expiration of Georgia's one-year redemption period.¹⁷ Given the general rule that property rights in bankruptcy are defined by state law, it follows that the debtor remained the owner of the property on the petition date and the property itself became property of the debtor's bankruptcy estate.¹⁸

While *Edwards* and *Woodley* interpreted Georgia law, their framework for analyzing what becomes property of a bankruptcy estate following a tax sale is consistent with bankruptcy court decisions throughout the nation.¹⁹ Aside from creating a right of redemption, a tax sale results in an unbundling of the rights that are commonly referred to as ownership: the right to possession, occupancy, use, rents and disposition. So, where a tax sale purchaser acquired rights of use and exclusive possession under Texas law, a bankruptcy court concluded that the property sold did not become property of

a debtor's bankruptcy estate.²⁰ The nature of the rights that are held by a debtor on the petition date guides bankruptcy courts' decisions as to whether a property, or only the right to redeem that property, becomes part of the bankruptcy estate.

Do Tax Sale Purchasers Hold Claims?

Determining the nature of a debtor's rights in a property sold at tax sale is the critical step in determining a tax sale purchaser's rights in bankruptcy. *Woodley*, and other decisions where the property itself is held to be property of the estate, characterize a tax sale purchaser's rights as a claim as defined by § 101(5).²¹ In cases where it was determined that the estate only included the debtor's right of redemption, it is usually determined that a tax sale purchaser does not hold a claim, but actually holds title to property with an obligation to relinquish title upon payment of the redemption price.²² The significance of the distinction is that claims could generally be modified through plans under chapters 11, 12 and 13. However, if the tax sale purchaser's interest is considered to be something other than a claim (such as title to the subject property), then the extension of redemption deadlines through a plan might be impermissible.

Courts determining that tax sale purchasers do not hold claims tend to interpret the applicable tax sale laws as divesting a taxpayer of title through the sale notwithstanding the continuing right of redemption. For example, in *In re Curley*, the court determined that under Louisiana law, a tax sale purchaser acquired title to the property being sold.²³ The court described the effect of the pre-petition tax sale of the debtors' property as follows:

Because the Tax Sale was complete, the tax obligation was satisfied. What remained was the Debtors' right of redemption. That right burdened [the tax sale purchaser's] ability to obtain title, but did not create an enforceable right to payment in favor of [the tax sale purchaser].... Thus, as of the Petition Date [the tax sale purchaser] held no claim against the Debtors.²⁴

Similarly, in *Callaway v. Harvest Assets LLC*, the court concluded under Georgia law that a tax sale purchaser did not hold a claim against the debtor/taxpayer, reasoning that the pre-petition tax sale had divested the debtor of title to the subject property.²⁵ While the tax sale purchaser was entitled to receive the redemption price as a condition of relinquishing the title to the debtor, this was a right enforceable by the debtor against the tax sale purchaser.²⁶ The tax sale purchaser could not compel redemption of the property by the debtor.²⁷

Those courts deciding that a tax sale purchaser holds a claim in a taxpayer's bankruptcy generally reason that a purchaser's right to keep a taxpayer's property in the absence of redemption is a right akin to a non-recourse mortgage.²⁸ Although a debtor may not have *in personam* liability to a tax sale purchaser, a right may fall within § 101(5)'s definition of a claim — even if it is enforceable solely through *in rem*

7 *In re Edwards*, 204 Bankr. LEXIS 5432, at *1-2.

8 *Id.*

9 *Id.* at *22.

10 *Id.* at *23.

11 *In re Woodley*, 579 B.R. at 631.

12 *Id.*

13 *Id.* at 632.

14 *Id.*

15 *Id.* at 633.

16 *Id.* at 632, n.4.

17 *Id.* at 636.

18 *Id.*; see *Butner v. United States*, 440 U.S. 48, 55, 99 S. Ct. 914, 918, 59 L. Ed. 2d 136, 141 (1979).

19 See, e.g., *Cnty. of Imperial Treasurer-Tax Collector v. Stadtmueller (In re RW Meridian LLC)*, 564 B.R. 21, 30 (B.A.P. 9th Cir. 2017) (debtor retained legal and equitable title to property after expiration of redemption period because tax sale process was not complete under California law); *In re Robinson*, 577 B.R. 294, 305 (Bankr. N.D. Ill. 2017) (pre-petition tax sale does not prevent property from becoming property of estate if process of divesting taxpayer of ownership was not completed pre-petition); *In re Millington*, No. 17-31290, 2017 Bankr. LEXIS 2214, at *5 (Bankr. S.D. Tex. Aug. 8, 2017); *In re Pittman*, 549 B.R. 614, 622 (Bankr. E.D. Pa. 2016) (holding under Pennsylvania law that property sold at pre-petition tax sale became property of debtor's estate because tax sale conveys only inchoate title without changing status of title of property owner).

20 *In re Millington*, 2017 Bankr. LEXIS 2214, at *5.

21 See, e.g., *id.* at 637; *In re Pittman*, 549 B.R. 614, 628 (Bankr. E.D. Pa. 2016); *In re Bates*, 270 B.R. 455, 464 (Bankr. N.D. Ill. 2001).

22 *Callaway v. Harvest Assets LLC*, No. 1:15-CV-570-ODE, 2015 U.S. Dist. LEXIS 185160, at *13 (N.D. Ga. Oct. 30, 2015); *In re Millington*, 2017 Bankr. LEXIS 2214, at *5.

23 *In re Curley*, 572 B.R. 622, 626 (Bankr. E.D. La. 2017).

24 *Id.* at 627-28; see also *In re Millington*, 2017 Bankr. LEXIS 2214, at *5.

25 2015 U.S. Dist. LEXIS 185160, at *13.

26 *Id.*

27 *Id.*

28 See *In re Woodley*, 579 B.R. at 637.

remedies.²⁹ For example, in *Johnson v. Home State Bank*, the U.S. Supreme Court held that a mortgage against a chapter 13 debtor's residence was a claim notwithstanding the discharge of the debtor's personal liability in a prior chapter 7 case.³⁰ The Court reasoned that § 502(b)(1)'s requirement that courts allow disputed claims except to the extent that they are "enforceable against either the debtor or his property" compels the conclusion that nonrecourse obligations fall with the definition of a "claim."³¹ Given that line of reasoning, it is logical for courts holding that property sold at a pre-petition tax sale becomes property of the estate to also hold that a tax sale purchaser's right to receive a redemption payment is a claim. If the property becomes property of the estate, then the right to payment of a redemption price is enforceable against property and is allowable under § 502(b)(1).³²

The principal purpose of deciding whether a tax sale purchaser holds a claim is to determine whether a debtor can redeem property sold at a pre-petition tax sale through plan payments extending beyond the applicable redemption deadline. With the exception of a 60-day post-petition grace period, § 108(b) generally provides that a debtor remains subject to deadlines set by a pre-petition agreement or applicable nonbankruptcy law. Notwithstanding § 108's ratification of nonbankruptcy deadlines, §§ 1123(b)(5), 1222(b)(2) and 1322(b)(2) allow for the modification of claims through a plan. It is § 108 that gives practical consequence to the controversy surrounding whether a tax sale purchaser holds a claim in a taxpayer's bankruptcy.

If the right to receive a redemption payment is a claim, then a chapter 11, 12 or 13 debtor could modify it through a plan.³³ If a tax sale purchaser's right to receive a redemption payment is not a claim, then the debtor/taxpayer that desires to redeem property sold pre-petition must do so by the applicable deadline under nonbankruptcy law or 60 days following the petition date.³⁴

Conclusion

There is no single answer as to whether a debtor can extend tax sale redemption payments over the life of a plan because the ways in which state laws unbundle the attributes of property ownership following tax sales are too varied to allow it. However, by examining what a taxpayer retains and what a purchaser takes through a tax sale, bankruptcy courts have developed a consistent analytical framework that should allow for the development of predictable results for debtors that have lost their property to pre-petition tax sales. **abi**

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²⁹ See 11 U.S.C. § 101(5)(B); *Johnson v. Home State Bank*, 501 U.S. 78, 84, 111 S. Ct. 2150, 2154, 115 L. Ed. 2d 66, 75 (1991) ("Even after the debtor's personal obligations have been extinguished, the mortgage holder still retains a 'right to payment' in the form of its right to the proceeds from the sale of the debtor's property.")

³⁰ *Johnson*, 501 U.S. at 84.

³¹ *Id.* at 85.

³² *Id.*

³³ See 11 U.S.C. §§ 1123(b)(5), 1222(b)(2) and 1322(b)(2); *In re Woodley*, 579 B.R. at 638-39.

³⁴ See *In re Curley*, 572 B.R. at 627-28, 631; *In re Edwards*, 2014 Bankr. LEXIS 5432, at *17-*18.