

*Buyer Beware? A Tax Sale Certificate Claim May Not Be a "Tax Claim" in the Property Owner's Bankruptcy Case.*



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*June 2010*

It is not difficult to anticipate that a property owner not paying real estate taxes may well end up as a debtor in Bankruptcy Court. A recent case of first impression for a New Jersey tax sale certificate holder found that while the tax sale purchaser will have a claim, and a lien, in the bankruptcy proceeding, it will not be able to receive payment of the New Jersey statutory interest rate on a "tax claim" but instead a judicially determined 'market' rate of interest, unlikely to be as favorable to the holder of the tax sale certificate. In re Princeton Office Park, L.P., Docket No. 08-27149 MBK, was a Chapter 11 reorganization proceeding pending in the United States Bankruptcy Court for the District of New Jersey before Judge Michael B. Kaplan. Judge Kaplan held that Plymouth Park Tax Services LLC, which had paid the property owner's taxes, on a 0% bid, with a substantial premium, did not hold a "tax claim" pursuant to 11 U.S.C. § 511(a); accordingly, Plymouth was not entitled to the 18% statutory interest rate and the bankruptcy court would set a rate of interest to be applied. The decision is presently on appeal to the U.S. District Court.

The Princeton Park facts were not in dispute; by agreement of the parties, the matter was decided on summary judgment. The changes to the Bankruptcy Code a few years ago included new limitations on a debtor's ability to modify the interest rate on "tax

claims." "If any provision of this title requires the payment of interest on a tax claim ... the rate of interest shall be the rate determined under applicable non-bankruptcy law." 11 U.S.C. § 511(a). In the context of a tax sale certificate, the applicable non-bankruptcy law would be New Jersey law. The term "tax claim," however, is not defined by the Bankruptcy Code. Judge Kaplan explored the issues raised by the lack of a definition, and held that, under New Jersey law, the holder of a tax sale certificate does not hold a "tax claim." First, in the absence of an overriding federal bankruptcy interest, property rights of claimants and debtors are determined under otherwise applicable non-bankruptcy law (either state law or non-bankruptcy federal law). The Court then reasoned that, by virtue of the tax sale certificate holder's having paid the underlying tax, there was no 'tax claim' any more. The result of Plymouth's payment of the underlying tax was a claim, and an accompanying lien, but not a "tax claim."

Key to the Court's view was the fact that Plymouth Park was not authorized to assess or collect taxes; accordingly it could not hold a "tax" claim or a "tax" lien, only a type of statutory lien, which could be satisfied by payment of the sum paid for the tax sale certificate at the accompanying redemption rate of interest fixed by statute.

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Judge Kaplan's analysis of New Jersey's tax sale statute showed that the payer gets a lien, not an assignment or a transfer of any taxing municipality rights; the municipality gets the money and the payer gets a lien with specified foreclosure rights if the owner does not redeem promptly enough. The tax sale certificate holder's position is subject to the municipality's future claims for unpaid taxes constituting "a continuous lien on the land." And, the holder's lien is subject to the rights of others acquiring subsequent tax sale certificates.

Further differentiating a tax sale certificate claim-and-lien from a "tax claim" was the fact that while a municipality holds a continuous lien for unpaid taxes without taking any affirmative action, a tax sale certificate holder's lien is not valid against third parties unless affirmative action (recording within three months) is taken.

Judge Kaplan found that redemption is accomplished not by payment of the amounts due for "unpaid taxes" but by payment of "the sum paid at the sale, with interest at the rate of redemption for which the property was sold." i.e., the amount needed is not a 'tax amount' but a 'reimbursement amount.' The Princeton Park Court had no evidence before it of "assignment"

or "subrogation" of municipality rights as was present in prior reported cases interpreting the tax sale law of other states and therefore it found the statutory lien was not a protected § 511 "tax claim."

If Princeton Office Park becomes binding law with respect to New Jersey real estate, holders of tax sale certificates will have a claim and a lien if the property owner ends up in bankruptcy prior to the redemption period, but the interest rate 'acquired' at the sale will not apply. Instead, the Bankruptcy Court will take and weigh evidence to determine an interest rate on the obligation pursuant to case law for non-tax claim liens in accordance with a 2004 decision of the United States Supreme Court.



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