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## Feature

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### Tax Certificate Sale and § 362 Automatic Stay Implications



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In order to raise revenue, local county and municipal governments nationwide collect various property taxes against all types of real property in every state. Some estimates provide that in the U.S., approximately \$426 billion in state and local taxes on real estate is owed each year.<sup>1</sup> To recover property taxes deemed to be delinquent due to the property owner's failure to timely pay the debt, the majority of states allow local tax collectors to sell tax certificates,<sup>2</sup> also known as certificates of purchase, tax executions, tax sale certificates or tax lien certificates, and roughly \$6 billion in tax certificates come up for sale each year.<sup>3</sup>

#### Tax Certificate Sale

The variations in state laws governing enforcement of tax liens are so great as almost to defy comparison.<sup>4</sup> Notwithstanding the wide variation in laws, there are certain features that are common to tax-collection laws. Generally, a tax certificate is an instrument representing unpaid delinquent taxes along with special assessments, interest and related costs and charges issued against a specific parcel of real estate.<sup>5</sup> Unpaid property taxes commonly become a lien on real estate.

In a tax certificate sale, instead of selling the actual property, the local governmental entity sells a lien<sup>6</sup> on the property, which is usually considered superior to all other liens in existence, with the pos-

sible exception of federal government liens such as those imposed by the Internal Revenue Service.<sup>7</sup> Accordingly, tax certificates do not transfer title or ownership of the property to the investor. In fact, one purchasing a tax certificate takes it subject to redemption rights.<sup>8</sup> A redemption right is the right to pay a specified amount to the tax collector in order to cancel and invalidate the tax certificate.<sup>9</sup>

However, not every person may redeem delinquent taxes. This privilege is reserved for those persons who have some legal interest in the subject property.<sup>10</sup> If not redeemed within a statutorily prescribed period of time, an investor may apply for a tax deed in order to obtain title to the subject property.<sup>11</sup>

As such, rather than borrowing money, many states rely on various investors to fill budgetary gaps arising from property owners' tax delinquencies, and tax certificate sales routinely help cash-strapped cities and counties efficiently collect millions of dollars in overdue taxes and other municipal bills. For example, a sale of approximately 38,000 tax lien certificates on a wide range of properties, from single-family homes to warehouses, allowed Miami-Dade County, Fla., to recover \$164 million in 2015.<sup>12</sup>

1 Morgan Brennan, "Vulture Investing: What You Need to Know Before Bidding for Tax Liens," *Forbes* (Dec. 22, 2012), available at [forbes.com/sites/morganbrennan/2012/11/26/vulture-investing-what-you-need-to-know-before-bidding-for-tax-liens](http://forbes.com/sites/morganbrennan/2012/11/26/vulture-investing-what-you-need-to-know-before-bidding-for-tax-liens) (unless otherwise specified, all links in this article were last visited on July 30, 2018).  
2 Tellingly, Washington, D.C., Puerto Rico and the U.S. Virgin Islands, along with 28 states, currently allow tax lien sales within their jurisdictions. *Id.*; see, e.g., Fla. Stat. § 197.432; O.R.C. § 5721.32; N.J. Rev. Stat. § 54:5-113; Jay Romano, "When Taxes on a Home Are Overdue," *New York Times* (March 30, 2003), available at [nytimes.com/2003/03/30/real-estate/your-home-when-taxes-on-a-home-are-overdue.html](http://nytimes.com/2003/03/30/real-estate/your-home-when-taxes-on-a-home-are-overdue.html).  
3 Brennan, *supra* n.1.  
4 H.K. Allen, "Collection of Delinquent Taxes By Recourse to the Taxes Property" (1936), available at [scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1821&context=icp](http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1821&context=icp).  
5 See, e.g., Fla. Stat. § 197.102(1)(f).

6 See, e.g., Fla. Stat. § 197.122(2); O.R.C. § 5721.10.  
7 See, e.g., O.R.C. § 5721.10; "A tax certificate is [a] lien for all taxes, penalties, and interest attached to any property upon which a lien is imposed by law on the date of assessment." Fla. Stat. § 192.053; see also 35 I.L.C.S. 200/21-75.  
8 See, e.g., O.R.C. §§ 5721.32 and 5721.38; *In re Smith*, 614 F.3d 654, 658 (7th Cir. 2010) ("The tax sale of the debtor's property only entitles the taxbuyer to a certificate of purchase, 35 ILCS 200/21-250, which has no effect on the delinquent property owner's legal or equitable title to the property.") (internal quotation marks omitted).  
9 See, e.g., O.R.C. § 5721.38; 35 I.L.C.S. 200/21-75.  
10 See, e.g., 35 I.L.C.S. 200/21-75(b). Under Ohio law, property owners are given notice of the opportunity to redeem the tax certificate and thereby remove the lien by paying the certificate-holder the purchase price plus interest, penalties and costs pursuant to O.R.C. § 5721.32(l).  
11 See, e.g., *In re Smith*, 614 F.3d at 659 ("It is not until the expiration of the debtor's redemption period and issuance of the tax deed that the taxbuyer acquires title and the right to be placed in possession of the property. 35 I.L.C.S. 200/22-40(c)."); *In re Donovan*, 266 B.R. 862, 868 (Bankr. S.D. Iowa) ("The tax sale certificate is evidence of the purchaser's equitable title and lien during the time for redemption. It entitles him to a tax deed after the requisites are met, and the time for redemption has expired.").  
12 Debora Lima, "Hedge Funds Dominate Miami-Dade Tax Lien Sales, to Critics' Dismay," *Miami Herald* (April 6, 2016), available at [miamiherald.com/news/business/real-estate-news/article70078967.html](http://miamiherald.com/news/business/real-estate-news/article70078967.html).

Following a sale, a tax certificate purchaser usually may collect the delinquent taxes, penalties, various charges, certain fees and interest on the late payment, which can theoretically run as high as 12-36 percent per year, depending on the state.<sup>13</sup> Unsurprisingly, there is stiff competition for tax liens among various investors, including, *inter alia*, lien-investment funds offering tax certificates as a means for diversification.

Currently, investment groups bid on sales in major metropolitan areas across the nation.<sup>14</sup> This practice has arisen because interest rates are determined by state law. As such, tax certificates are immune to many of the fluctuations in the financial markets that affect more traditional forms of investments. However, tax certificates are not risk-free investments. Litigation, liens deemed invalid due to procedural errors and, pertinent to this article, a property owner's bankruptcy may all impact the collectability of a tax certificate.

### Automatic Stay Implications

A property owner's bankruptcy filing might affect the rights of tax certificate stakeholders, including the standing to file a proof of claim<sup>15</sup> and a right to challenge proposed interest rate changes by the debtor.<sup>16</sup> However, most problematic are the implications of the automatic stay provided for in 11 U.S.C. § 362. The main objective of a tax certificate sale is to enforce payment of the tax assessment and maximize collections of delinquent taxes to raise much-needed revenue to fund local education, police and fire departments, local governments, and other local infrastructure.

However, the Bankruptcy Code unequivocally states that the filing of a bankruptcy petition operates as a stay applicable to all entities, including governmental ones, of any act to, *inter alia*, enforce any lien against property of the estate.<sup>17</sup> Notably, there is a body of case law, albeit based not only on § 362 but also on a local statutory dynamic, finding that the sale of a tax certificate constitutes a violation of the automatic stay.<sup>18</sup>

Such decisions have been justified for myriad reasons. The most commonly relied-upon reason is the argument that the automatic stay prevents disparate actions against debtors, and protects credi-

tors in a manner that is consistent with bankruptcy's goal of equal treatment of all creditors from moving against a debtor's property during the pendency of the bankruptcy proceedings.<sup>19</sup> This equitable treatment requires that all creditors, both public and private, be subject to the automatic stay.<sup>20</sup>

Another reason to find that the sale of tax certificates violates the automatic stay is that if the debtor wanted to redeem the property, he/she would have to pay the amount of the tax lien plus the expenses incurred by the tax sale, effectively forcing the debtor to appear or be subjected to further incidental expenses.<sup>21</sup> Based on the foregoing, since such sales impinge upon the debtor's "breathing spell" contemplated by § 362, certain bankruptcy courts would void the sale *ab initio*.<sup>22</sup> As such, following a bankruptcy filing, tax collectors are reluctant to sell tax certificates due to a fear of causing a violation of the automatic stay.

### Blanket Confirmation Regarding Inapplicability of the Automatic Stay to Tax Certificate Sales

Most recently, the U.S. Bankruptcy Court for the Middle District of Florida entered an unprecedented nationwide administrative order providing a blanket confirmation that the automatic stay under § 362(a) does not prohibit Florida tax collectors from selling tax certificates relating to the property of a debtor in bankruptcy or bankruptcy estate.<sup>23</sup> This administrative order addressed an apparent need for streamlining the collection of delinquent taxes enforced by tax certificate sales, recognizing that obtaining an order lifting the automatic stay in each case where a tax certificate is statutorily ripe for sale would be cumbersome, costly and inefficient.<sup>24</sup>

The benefit of this order is evident, as it places the local governmental entities in immediate possession of funds, the receipt of which would otherwise be delayed.<sup>25</sup> In addition, the court pointed out another benefit of proceeding with the tax certificate sale:<sup>26</sup> A successful sale would lead to a reduction of the tax burden on a particular property with the potential to conserve bankruptcy estate assets.<sup>27</sup>

In Florida, tax certificate sales are conducted in a reverse-auction style, with various participants bidding downward on the interest rates starting, as prescribed by Florida statutes, at 18 percent.<sup>28</sup> The certificate is awarded to the bidder who will pay the outstanding taxes for a particular year, interests and

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13 Brennan, *supra* n.1.

14 *Id.*; Lima, *supra* n.12.

15 Tax certificate stakeholders are creditors with standing to file claims and are the real parties-in-interest entitled to directly receive payments under chapter 13 plans. See generally *In re Lago*, 301 B.R. 365, 367 (Bankr. S.D. Fla. 2003).

16 *But see In re Walsh*, 264 B.R. 482, 482 (Bankr. E.D. Ohio 2001) (debtor was unable to alter interest rate under chapter 13 plan).

17 11 U.S.C. § 362.

18 See, e.g., *In re Matter of Isley*, 104 B.R. 673, 679 (Bankr. D.N.J. 1989) (holding that under laws of New Jersey, sale of tax certificates for taxes for year in which debtor filed bankruptcy petition violated automatic stay); *In re Ballentine Bros. Inc.*, 86 B.R. 198, 202 (Bankr. D. Neb. 1988) ("State and local governmental units cannot, by an exercise of their police or regulatory powers, subvert the relief afforded by the federal bankruptcy laws."); *In re Formisano*, 148 B.R. 217, 224 (Bankr. D.N.J. 1992) (holding that tax certificate sale violated the automatic stay); *In re Matter of 2009 Corp.*, 13 B.R. 1006, 1008 (Bankr. S.D. Fla. 1981) (finding sale of tax certificate following bankruptcy filing "unlawful and, therefore, ineffectual and a nullity").

19 *In re Matter of Isley*, 104 B.R. at 679.

20 *Id.*

21 *Id.*

22 *Id.*

23 *In re Administrative Order Regarding Sale of Tax Certificates by Florida Tax Collectors*, 583 B.R. 794 (Bankr. M.D. Fla. 2018).

24 *Id.* at 795.

25 *Id.*

26 *Id.*

27 *Id.* at 795-76.

28 Fla. Stat. § 197.432(6); see, e.g., Charles W. Thomas, "Tax Certificate and Tax Deed Sales," Pinellas County Tax Collector, available at [taxcollect.com/tax-certificate-deed-sales](http://taxcollect.com/tax-certificate-deed-sales).

costs, and accept the lowest rate of interest.<sup>29</sup> The tax collector can accept bids in even increments and in fractional interest rate bids of one-quarter of 1 percent.<sup>30</sup>

Once tax collectors hesitate to conduct a tax certificate sale out of an abundance of caution, the benefits of the sale are not realized — not only by governmental beneficiaries, but also by the debtor, estate and creditors.<sup>31</sup> In fact, depriving the debtor of an opportunity to pay a lower rate puts further limitations on the debtor's cash flow, possibly to the detriment of the debtor's other creditors.<sup>32</sup> Namely, lienholders junior to a tax lien are denied the benefit of a reduction in statutory interest rate, which leads to more rapid erosion of equity in the collateral property.<sup>33</sup> Lastly, in the absence of a tax lien sale, once junior lienholders elect to foreclose their lien, they will have to pay a higher tax bill.<sup>34</sup>

In addition, the Florida Bankruptcy Court emphasized that the rules of procedure anticipate analogous transfers of claims within bankruptcy, whether secured or unsecured, and provide a framework for noting the record accordingly.<sup>35</sup> Based on its inability to discern any substantive difference between the sale of tax certificates authorized under § 197.432, Florida statutes and transfers of claims as authorized by Rule 3001(e) of the Federal Rules of Bankruptcy Procedure, the court noted that nothing in § 362 suggests that such transfers automatically constitute a violation of the automatic stay.<sup>36</sup>

However, the court cautioned that any sale of the property of the estate or property of a debtor in bankruptcy is protected by the automatic stay.<sup>37</sup> As such, absent a termination of the stay by operation of law or entry of an order modifying the stay, any sale of a tax deed would be void.<sup>38</sup>

## Conclusion

Due to the lag time between the decline in home values and the drop in property tax revenue, local governments were the last to emerge from the Great Recession.<sup>39</sup> In addition to the decline in real estate tax revenue, more cuts are likely in the coming years as states have limited aid to local governments and the federal government slashes spending to reduce the federal budget deficit. Recent chapter 9 filings across the nation show an urgent need to foster efforts to stimulate tax payments, while the automatic stay provides an incentive to prolong delinquencies. Therefore, in light of the practical advantages to bankruptcy participants, the entry of such an administrative order was prudent and much needed in today's economic reality. **abi**

<sup>29</sup> Thomas, *supra* n.28.

<sup>30</sup> Fla. Stat. § 197.432(6).

<sup>31</sup> *In re Administrative Order*, 583 B.R. at 795.

<sup>32</sup> *Id.* at n.2.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 796.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*; see also *United States (By and Through FHA) v. Eagle Investment Co. (In re Crosby)*, 109 B.R. 195, 197 (Bankr. S.D. Miss. 1989) (holding that tax sale was direct violation of automatic stay and was therefore null and void); *In re Stewart*, 190 B.R. 846, 854 (Bankr. C.D. Ill. 1996) (actions to obtain tax deed constituted violation of § 362(a)(6)); *Carter v. R.R. & Indus. Fed. Credit Union*, 675 So. 2d 685, 686 (Fla. 2d D.C.A. 1996) (stating that tax deed issued in violation of the automatic stay is void); *In re Donovan*, 266 B.R. 862, 870-71 (Bankr. S.D. Iowa 2001) (holding that tax deed that was issued in violation of automatic stay and that successful bidder at tax foreclosure sale was not entitled to retroactive relief from stay); *In re Lambert*, 273 B.R. 663, 668 (Bankr. N.D. Fla. 2002) (holding that issuance of tax deed by county clerk of court was not mere ministerial act, but violation of automatic stay that was void *ab initio*).

<sup>39</sup> Susan K. Urahn, "The State Role in Local Government Financial Distress," PEW Charitable Trusts' Report, at 7 (July 2013).

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