

N.J. Supreme Court Fortifies Public Policy Promoting Tax Sale Certificates

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October 6, 2014



In a pending bankruptcy appeal to the Third Circuit, upon certified question, the New Jersey Supreme Court was asked to consider whether a tax lien continues to exist against the subject property after the lien is sold by the municipality to a third-party purchaser of a tax sale certificate. A tax lien is a lien based on the property owner's obligation to pay taxes to the municipality, or an in rem obligation, as opposed to another form of lien independent of such obligations. The distinction is significant in the context of a bankruptcy proceeding where, under certain circumstances, a debtor is permitted to reduce or "cram down" the contractual or statutory rate of interest on a debt. The Bankruptcy Code prohibits a debtor from so modifying interest rates, however, with respect to those claims constituting "tax claims."

In the case of *In re: Princeton Office Park v. Plymouth Park Tax Services*, Princeton Office Park, a real estate development company, fell delinquent in its real estate tax obligations to the Township of Lawrence, giving rise to a continuous lien on Princeton Office Park's property pursuant to N.J.S.A. 54:5-6. In accordance with the Tax Sale Law, N.J.S.A. 54:5-1 to -137, the township conducted a public auction of its municipal tax lien on Dec. 19, 2005, and issued a tax sale certificate to the winning bidder, Plymouth Park, transferring its lien on the property subject to redemption by the property owner and other interest holders. As the New Jersey Supreme Court has previously recognized, this procedure has the effect of converting the municipality's lien into a stream of revenue by encouraging the purchase of tax certificates on tax-dormant properties, and provides a municipal financing option as a mechanism to transform a nonperforming asset into cash without raising taxes. Set by statute, the redemption amount accrued interest at a rate of 18 percent following the sale.

Upon expiration of the two-year waiting period prescribed by the Tax Sale Law, Plymouth Park sought to foreclose its lien and bar Princeton Office Park and others from exercising the right of redemption. Before the foreclosure process was complete, Princeton Office Park filed for Chapter 11 bankruptcy in the United States Bankruptcy Court of the District of New Jersey. Plymouth Park filed a proof of claim in Princeton Office Park's bankruptcy case citing "taxes" as the basis of the debt obligation. Princeton Office Park's proposed Chapter 11 plan provided for extended satisfaction of Plymouth Park's claim with interest at 6 percent (the market rate at the time) to be secured by a note and mortgage. Plymouth Park objected pursuant to Section 511(a) of the Bankruptcy Code, which provides that if a creditor's claim constitutes a "tax claim," "the rate of interest shall be the rate determined under applicable nonbankruptcy law," which in this case was 18 percent.

In deciding Princeton Office Park's motion to fix Plymouth Park's claim amount, interest rate and payment terms, Judge Kaplan of the New Jersey Bankruptcy Court held that Plymouth Park could not avail itself of the antimodification provision of the code to preserve its 18 percent interest rate, because Plymouth Park's claim did not constitute a "tax claim." Acknowledging that a tax lien would certainly fit into the Bankruptcy Code's definition of tax claim, Judge Kaplan turned to New Jersey law to determine whether the holder of a tax sale certificate possessed a tax lien on the subject property, as opposed to some other type of statutory lien falling outside the scope of Section 511(a).

In holding that Plymouth Park did not possess an allowed claim for tax, Judge Kaplan reasoned that, unlike the law in other states, the New Jersey Tax Sale Law does not make the purchaser of a tax sale certificate an assignee or subrogee of the taxing authority or designate a purchaser of a tax sale certificate as a transferee of the tax claim. Rather, the law has been interpreted as conveying to the purchaser a mere lien on the underlying property. Moreover, there can be no transfer of the municipality's tax lien because the certificate holder has paid the underlying taxes. Judge Kaplan also found compelling the fact that, unlike a municipality, a certificate holder is not empowered to assess or collect taxes, and its rights are far more restricted. Accordingly, Judge Kaplan concluded that the certificate holder's lien merely secures the redemption price owed as a result of the certificate holder's having paid the debtor's tax obligation, not the underlying tax obligation, and therefore its claim is not a tax claim.

The District Court of New Jersey affirmed for substantially the same reasons and an appeal was made to the Third Circuit who certified the following question to the NJ Supreme Court: whether, under New Jersey law, the purchaser of a tax sale certificate holds a tax lien.

While the appeals in this case were pending, the New Jersey Bankruptcy Court became split on the issue, with one judge coming down on the same side as Judge Kaplan, *see In re Burch*, No. 10-11360, 2010 Bankr. LEXIS 2363; 2010 WL 2889520 (Bankr. D.N.J. July 15, 2010) (Wizmur, J.), and three other judges ruling to the contrary. *See In re Kopec*, 473 B.R. 597 (2012) (Ferguson, J.); *In re Curry*, 493 B.R. 447 (2013) (Winfield, J.); *In re Blackpool Investors Group, Ltd.*, 509 B.R. 470 (2014) (Gambardella, J.).

Repudiating the decision of the Bankruptcy Court and the reviewing district court, the New Jersey Supreme Court answered the Third Circuit's certified question in the affirmative—the purchaser of a tax sale certificate does in fact hold a tax lien. Guided by established principles of statutory construction and with the remedial purpose of the statute in mind, the New Jersey Supreme Court examined the plain language of the Tax Sale Law in an effort to "divine and effectuate" the legislature's intent. Citing five provisions of the Tax Sale Law, the court found evidence of the legislature's intent that "the debt underlying a certificate holder's lien is the property owner's obligation to pay taxes, and that the lien conferred with the certificate is a tax lien."

The court concluded that a municipal lien is created by operation of N.J.S.A. 54:5-6 and is conveyed to the purchaser of the tax sale certificate pursuant to N.J.S.A. 54:5-42. "The purchaser of the tax sale certificate thus acquires a lien formerly held by the municipality's taxing authority, derived from the property owner's obligation to pay real estate taxes." Further evidence supporting this determination of the legislature's intent is its interchangeable use of the terms "tax sale certificate" and "tax lien certificate." In addition, in N.J.S.A. 54:5-43, the legislature acknowledged that the certificate holder has an "interest in the tax" and the "municipal lien therefore." Finally, N.J.S.A. 54:4-67 makes clear that the tax obligation is not satisfied by the certificate holder's payment of the outstanding taxes to the municipality and the taxes remain delinquent. The court was unpersuaded by the argument that N.J.S.A. 54:4-67 was abrogated by decision of the Tax Court in *Ramos v. Passaic City*, 19 N.J. Tax 97 (Tax 2000), which held that the 1997 amendment to the statute adding

the aforementioned language was unconstitutional on due process grounds. The court reasoned that the Tax Court's opinion in *Ramos* does not undermine the expression of legislative intent found in the text of the statute.

Since receiving the New Jersey Supreme Court's answer to its certified question on June 25, the Third Circuit has not taken any further action in light of the pending appeal of another Order of the Bankruptcy Court disallowing Plymouth Park's claim and ordering that Plymouth Park's right, title and interest in the tax sale certificate and any lien related thereto or arising therefrom is forfeited to Princeton Office Park. The Third Circuit has requested briefing on whether the instant appeal will be rendered moot if the Bankruptcy Court's Order disallowing Plymouth Park's claim is upheld by the District Court. Despite the controversy that may arise with respect to the effect of the New Jersey Supreme Court's opinion on the current bankruptcy court split if the Third Circuit ultimately dismisses this appeal as moot, the conclusion that the purchaser of a tax sale certificate holds a tax lien on the subject property seems inescapable in light of the Erie Doctrine. See *O'Donnell v. Simon*, 362 Fed. Appx. 300, 305 (3d Cir. 2010). The Erie Doctrine requires federal courts to follow state law as announced by the highest state court, and if no such pronouncement has been made, to predict how the state supreme court would decide the issue.

There is no doubt that the Supreme Court's decision lends crucial support to New Jersey's sound public policy in favor of tax sale certificates as a means of raising municipal revenue and off-setting taxes by ensuring that tax sale certificates remain an attractive investment for third parties. Fallout from the Bankruptcy Court's decision was ominous and amicus curiae National Tax Lien Association warned that affirmation of the Bankruptcy Court's decision would effectively eliminate the New Jersey market for tax sale certificates, a prospect with tremendous consequence to municipalities and taxpayers. However, the ruling is not without negative impact. It presents an additional hurdle to reorganizing debtors and shifts the financial burden to other classes of creditors who may be forced to accept a lower rate of return on their investment to compensate for the debtor's inability to cram down the interest rate on a tax sale certificate. •

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