

The purchaser of a tax lien is the holder of a “tax claim” under 11 U.S.C. §511(a)

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Introduction

Governmental entities may place a tax lien against property for delinquent taxes owed on such property or as a result of the property owner's failure to pay income or other taxes. Once the tax lien is perfected, the governmental entities can either enforce the lien or sell the liens, in order to recover the delinquent taxes.¹ Private entities may purchase the liens, which often impose high interest rates on the debtors.² A purchaser of the tax liens will be able to collect payment directly from the debtor when the property is sold or, if necessary, foreclose, while the government entity can use the proceeds from the sale to reduce its own debt. Issues often arise when the debtor subsequently files for bankruptcy and attempts to reduce the interest rate on the tax lien.

Generally, under section 511(a), if the holder of a “tax claim” is entitled to be paid interest, or enable a creditor to receive the present value of the allowed amount of a tax claim, the interest rate of interest to be paid on such tax claim shall be “determined under applicable

¹ See Jay Romano, *Tax Liens Can Enrich Investors*, N.Y. TIMES, Aug. 15, 1999, available at, <http://www.nytimes.com/1999/08/15/realestate/your-home-tax-liens-can-enrich-investors.html>.

² See *id.*

nonbankruptcy law.”³ As a result, the debtor cannot modify, or “cram down,” the interest rate in accordance with *Till v. SCS Credit Corp.*⁴ Recent cases have addressed the issue of whether a purchaser of a tax lien is entitled to the anti-modification protections provided under section 511(a) of the Bankruptcy Code.

In those cases, the debtors proposed to reduce the interest rates on tax liens that have been sold to third parties.⁵ In particular, each debtor have argued that he was permitted to “cram down” the applicable interest rate under *Till* because the creditors who purchased the tax liens did not hold a “tax claim” within the meaning of section 511(a).⁶ While a minority of courts has found that debtors can modify the interest rates on the tax liens because the private purchasers do not hold a “tax claim,” the majority of courts have found that the purchasers are able to assert the non-bankruptcy rates pursuant to section 511(a).⁷

This Article is divided into four parts: Part I examines the relevant statutory provisions; Part II addresses the first step of a courts analysis when determining that a purchaser is a creditor; Part III explains the factors courts consider when determining if a “tax claim” is held; Part IV discusses the impact of the analysis used by the courts.

I. Section 511(a) of the Bankruptcy Code

Section 511(a) of the Bankruptcy Code provides that in bankruptcy: the payment of interest on a tax claim or on an administrative expense tax, or the payment of interest to enable a creditor to receive the present value of the allowed amount of a tax claim, the rate of interest shall be the rate determined under applicable nonbankruptcy law⁸

³ 11 U.S.C. §511 (a) (2012).

⁴ *See* 541 U.S. 456 (2004).

⁵ *See In re Debenedetto*, No. 10–14103, 2013 WL 3831062, *1 (Bankr. N.D.N.Y. 2013). *In re Kopec*, 473 B.R. 597 (Bankr.. D.N.J. 2012); *In re Meyhoefer*, 459 B.R.167 (Bankr.. N.D.N.Y 2011); *In re Kizzee-Jordan*, 626 F.3d 239 (5th Cir. 2010).

⁶ *See Id.*

⁷ *See Id.*

⁸ 11 U.S.C §511(a)(2012).

Therefore, section 511(a), does not allow for the debtor in bankruptcy to “cramdown” the interest rate on debt when a creditor is a holder of “tax claim.”

In *Till v. SCS Credit Corp.* the Supreme Court described a method by which a debtor in chapter 13 cases may “cramdown” the contracted interest rate by applying the “formula rate.”⁹ However, the opinion contains potentially inconsistent language regarding the method for cramming down in chapter 11 cases. In dicta, the opinion suggested that either the “formula rate” or the “efficient-market rate” may be applied to cramdown interest.¹⁰ Bankruptcy courts after *Till* have noted that “although *Till* was instructive, it was not controlling in all chapter 11 cases.”¹¹ The Sixth Circuit expanded on this by applying the “efficient-market rate” method to determine the cramdown interest rate.¹² The court in *American HomePatient* reasoned that such a rate should be applied when there is an efficient market, but when there is no market then the formula rate should be applied.¹³ While it is still unclear what rate described in *Till* is appropriate to apply in chapter 11 cramdown’s, section 511(a) will still prevent either form of cramdown if the creditor is a holder of a tax claim under any of the approaches adopted by the courts.¹⁴ Therefore, the issue before the courts has been whether the creditor held a “tax claim” and received the anti-modification protection of section 511(a).¹⁵

II. Determining whether a private purchaser of tax debt is a creditor

⁹ Richard E. Mikels, *The Developing Impact of Till v. SCS on Chapter 11 Reorganizations*, 24-10 AM. BANKR. INST. J. 12 (2005).

¹⁰ *See Id.*

¹¹ *See Id.* at 54.

¹² *See Id.* quoting *In re American HomePatient, Inc.* 420 F.3d 559, 568 (6th Cir. 2005).

¹³ *See Id.* quoting *In re American HomePatient, Inc.* 420 F.3d at 568.

¹⁴ 11 U.S.C §511(a).

¹⁵ *See Id.*

Before turning to the main question of whether a “tax claim” exists, courts examine whether a purchaser of tax debt is a creditor under section 511(a).¹⁶ Courts have decided that the term “creditor” within the meaning section 511(a) includes private entities that purchase tax liens.¹⁷ The courts have noted that Congress has broadly defined “creditor” and “claim”, while explicitly defining “governmental unit.”¹⁸ This distinction is important to the courts’ reasoning because it shows that if Congress intended a term to be read narrowly, Congress would have explicitly defined the term. Therefore, since Congress did not explicitly define the term “creditor,” the term should be read broadly to include private entities within the meaning of section 511.¹⁹ Once a court decides that private entities who purchase tax liens are creditors for the purposes of section 511(a), the court will determine whether the purchaser holds a “tax claim” under section 511(a).

III. Determining whether a creditor has a “tax claim” under section 511(a)

Courts have considered two factors when determining whether a purchaser of a tax lien has a “tax claim” for the purposes of section 511(a): (1) whether of the sale of the tax lien extinguished the underlying tax debt, and (2) whether there was a continuity of rights as between the original holder of the tax lien and the private purchaser.

a. Whether the sale of the tax lien extinguished the underlying tax debt

¹⁶ *See Id.*

¹⁷ *See In re Debenedetto*, No. 10–14103, 2013 WL 3831062, *1 (Bankr. N.D.N.Y. , 2013). *In re Kopec*, 473 B.R. 597 (Bankr.. D.N.J. 2012); *In re Meyhoefer*, 459 B.R.167 (Bankr.. N.D.N.Y 2011); *In re Kizzee-Jordan*, 626 F.3d 239 (5th Cir. 2010).

¹⁸ *See* 11 U.S.C.§101(5)(A);(10)(A);(27).

¹⁹ *See In re Debenedetto*, 2013 WL 3831062 at *1; *In re Kopec*, 473 B.R. at 597; *In re Meyhoefer*, 459 B.R.at 167; *In re Kizzee-Jordan*, 626 F.3d at 239.

The first factor courts have looked to is whether the sale of the tax lien by the municipality to a private entity extinguishes the underlying tax debt.²⁰ This factor is important because the debt needs to be maintained after the purchase for the purchase to hold a tax claim under section 511(a).²¹ The minority of courts, one bankruptcy court in New Jersey, has decided that the purchase of tax debt extinguished the underlying debt and therefore the purchaser only held a lien interest not protected by section 511(a).²² However, the majority of courts have found that the purchase of tax debt did not extinguish the underlying tax debt. As a result, the purchaser held a tax claim and could receive the anti-modification protection of section 511(a).²³

i. The purchase of a tax lien extinguishes the underlying tax debt

In *In re Princeton Office Park, L.P.*²⁴, the court held that under New Jersey law the holder of a tax sale certificate is not a holder of a “tax claim” within the meaning of section 511(a).²⁵ In *Princeton Office Park*, the debtor was a real estate development company that owned real property in Lawrence Township in New Jersey.²⁶ Plymouth Park, a private entity, purchased municipal tax liens against the debtor’s property.²⁷ When the debtor filed bankruptcy claim, Plymouth Park filed proof of claim for outstanding taxes “taxes.”²⁸ The debtor’s proposed plan provided for satisfaction of Plymouth Park’s claim at a reduced interest rate.²⁹ Plymouth Park objected to the plan, arguing that the debtor could not reduce the interest rate because Plymouth

²⁰ *See Id.*

²¹ *See Debenedetto*, 2013 WL 3831062 at *3.

²² *See In re Princeton Office Park, L.P.*, 423 B.R. at 797.

²³ *See In re Debenedetto*, 2013 WL 3831062 at *1; *In re Kopec*, 473 B.R. at 597; *In re Meyhoefer*, 459 B.R. at 167; *In re Kizzee-Jordan*, 626 F.3d at 239.

²⁴ 423 B.R. 795 (Bkrctcy. D.N.J. 2010).

²⁵ *See Id.* at 797.

²⁶ *See Id.*

²⁷ *See Id.*

²⁸ *See Id.* at 798.

²⁹ *See Id.*

was the holder of a “tax claim” and was protected by the anti-modification provision of section 511(a).³⁰ The debtor responded that section 511(a) did not apply because Plymouth Park’s claim was not a “tax claim” under New Jersey law.³¹

The *Princeton* court determined that Plymouth Park did not have a “tax claim” under section 511(a) because the court found that the purchase of the tax lien extinguished the underlying claim.³² In particular, the court determined, that under to New Jersey law, the tax sale was “simply conveying to the purchaser of a tax sale certificate a ‘lien’ on the underlying property.”³³ The court reasoned that there was no transfer of a tax claim because all of the “taxes [were] paid in full at the conclusion of the tax sale” and “all that remain[ed] [was] a lien against the [p]roperty.”³⁴ As a result the underlying tax debt had been extinguished upon the sale and the purchaser did not hold a “tax claim” under section 511(a).³⁵ Therefore, Plymouth Park was not entitled to the anti-modification protection of section 511(a), and the interest rate on the tax liens would be calculated in accordance with *Till* and its progeny.³⁶

ii. The purchase of a tax lien does not extinguish underlying tax debt

The majority of courts have found that the purchase of tax debt by a private entity does not extinguish the lien’s underlying debt.³⁷ For example, in *In re Debenedetto*³⁸ a private entity

³⁰ *See Id.* at 798-99.

³¹ *See Id.*

³² *See Id.* at 804.

³³ *Id.*

³⁴ *Id.*

³⁵ *See Id.* at 805-06.

³⁶ *See Id.* at 808.

³⁷ *See In re Debenedetto*, No. 10–14103, 2013 WL 3831062, *1 (Bankr. N.D.N.Y. 2013); *In re Kopec*, 473 B.R. 597 (Bankr.. D.N.J. 2012); *In re Meyhoefer*, 459 B.R.167 (Bankr.. N.D.N.Y 2011); *In re Kizzee-Jordan*, 626 F.3d 239 (5th Cir. 2010).

³⁸ No. 10–14103, 2013 WL 3831062, *1 (Bankr. N.D.N.Y. 2013).

purchased tax liens against the debtor’s property for delinquent taxes from a local municipality.³⁹ The debtor subsequently filed for bankruptcy under chapter 13 and proposed a chapter 13 plan.⁴⁰ The purchaser filed multiple proofs of claim that included the tax liens plus interest at non-bankruptcy rate of twenty-one percent.⁴¹ The debtors objected to the purchaser’s claims, asserting that the purchaser was not entitled to assert the non-bankruptcy interest rate of twenty-one percent. The debtor argued that the purchaser was not a holder of a tax claim under section 511(a), and therefore, the purchaser could not assert the non-bankruptcy rate.⁴²

In rejecting the debtor’s argument, the *Debenedetto* court determined that the purchase of the delinquent tax lien from the municipality did not extinguish the underlying tax debt.⁴³ The court explained that the underlying tax debt was not paid in full at the time of the purchase and therefore was not extinguished.⁴⁴ Of particular importance to the court’s ruling was the fact that the city could repurchase the tax liens sold and enforce the repurchased tax liens.⁴⁵ Since the underlying tax debt remained intact the purchaser held a “tax claim” and was entitled receive the anti-modification protection under section 511(a).

The court in *In re Kopec*⁴⁶ came to a similar conclusion. In *Kopec* the purchaser acquired a tax lien certificate from the municipality.⁴⁷ When the debtor filed his chapter 13 plan, the debtor only proposed to pay an interest on the tax liens at a rate of four percent. The purchaser

³⁹ *See Id.* at *1.

⁴⁰ *See Id.*

⁴¹ *See Id.*

⁴² *See Id.*

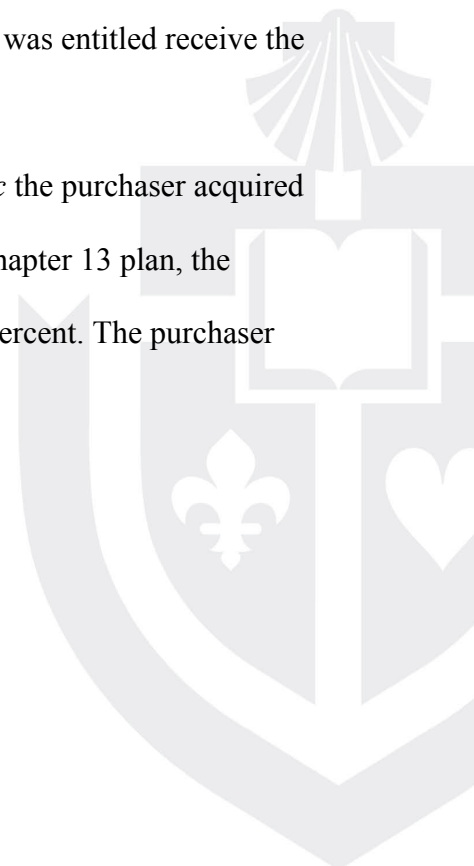
⁴³ *See Id.* at *3.

⁴⁴ *See Id.*

⁴⁵ *See Id.*

⁴⁶ 473 B.R. 597, 602 (Bankr.. D.N.J. 2012).

⁴⁷ *See Id.* at 598.



subsequently filed a proof of claim for the tax liens that included the statutory interest rates of fourteen and eighteen percent.⁴⁸

To determine if the purchaser could be protected under section 511(a), the court analyzed whether the underlying debt was fully extinguished when it was purchased. The court found that the underlying tax debt could not have been extinguished on the sale because if it had been there would no debt to support the lien held by the purchaser.⁴⁹ Therefore, the only basis for the lien held by the purchaser must have been the original tax debt.⁵⁰ As a result, the purchaser held a “tax claim” for the purposes of section 511(a) and would be protected by the section’s anti-modification provision.⁵¹

While the court in *In re Kizzee-Jordan*⁵² also determined that the underlying tax debt was not extinguished upon the sale of a tax lien, the court considered another factor when it made that determination. The *Kizzee-Jordan* court reasoned that because the tax lien could be further transferred after the completion of the sale, the underlying debt had to be maintained beyond the sale.⁵³ Therefore, the tax lien could not have been transferred if the underlying tax debt was extinguished.⁵⁴ In addition, the court further analyzed relevant state statutes and noted that these statutes permitted the transferee to pay any future taxes for the debtor and receive the tax receipt and lien.⁵⁵ The court reasoned that if the tax debt was extinguished the taxing authority would issue a receipt to the debtor not the purchaser.⁵⁶ As a result, the court found that “the nature of

⁴⁸ *See Id.*

⁴⁹ *See Id.* at 600.

⁵⁰ *See Id.* at 602.

⁵¹ *See Id.* at 603.

⁵² 626 F.3d 239 (5th Cir. 2010).

⁵³ *See Id.* at 244-45.

⁵⁴ *See Id.*

⁵⁵ *See Id.* at 244.

⁵⁶ *See Id.*

the underlying debt upon which the claim is based” was not altered.⁵⁷ Therefore, the creditor maintained a “tax claim” against the debtors under section 511(a) and was protected from the modification of the interest rate.⁵⁸

b. Whether there was a continuity of rights as between the original holder of the tax lien and the private purchaser

Another factor courts have considered in determining whether a tax claim was transferred to the purchaser is whether there is a continuity of rights between the original holder of the tax lien and the private purchaser.⁵⁹ If the purchaser of the tax lien maintains similar rights with respect to the debtor as the original holder of the lien, then courts are likely to find that the purchaser holds a tax claim for the purposes of section 511(a). For example, the *Debenedetto* court looked to the specific language of the purchase agreement to determine if there was a continuity of rights between the purchaser and the municipality. The court found that in the terms of the purchase agreement the municipality had “assigned substantially all of its rights and remedies” to the purchaser.⁶⁰ Therefore, the court combined this factor with the court’s determination that the purchase did not extinguish the underlying debt and found that the purchaser held a tax claim under section 511(a). As a result, the purchaser was entitled to the anti-modification protection of section 511(a).

This factor was also important when the *Princeton* court found that a purchaser did not hold a tax claim under section 511(a).⁶¹ Specifically, the *Princeton* court opined that since the rights of the holder of the tax sale certificate “differ[ed] significantly from those of a

⁵⁷ *See Id.*

⁵⁸ *See Id.* at 244-46.

⁵⁹ *See In re Debenedetto*, No. 10–14103, 2013 WL 3831062, *4 (Bankr. N.D.N.Y. , 2013).

⁶⁰ *Id.* at *4.

⁶¹ *See In re Princeton Office Park, L.P.*, 423 B.R. 795, 804 (Bkrctcy. D.N.J. 2010).

municipality holding a tax claim” and there had not been an assignment of rights by the municipality to the purchaser, the purchaser did not hold a “tax claim.”⁶² The court further explained that because the rights of the purchaser differed substantially from that of the municipality, the purchaser merely held a lien against the property but not a tax claim protected by the statute.⁶³ The court reasoned that differences show the debtor is not paying taxes and therefore are not subject to a tax claim.⁶⁴ Therefore, in *Princeton*, the court held the purchaser was not entitled the anti-modification protection under section 511(a).

IV. Implications of this trend

As government entities continue to sell their tax liens, important considerations for purchasers of liens emerge from the cases addressing section 511(a) protection. Therefore, the importance of the cases addressing section 511(a) is that they establish the important factors which purchasers of tax liens should take into account when structuring purchase agreements to acquire tax liens from a municipality. First, the purchasers must be able to establish they are creditors under section 511(a). Second, purchasers should be able to show that the underlying debt was not extinguished on the purchase. Finally, purchasers must show through statutory language or specific language in the purchase agreement that they have the similar rights as the municipality.

In order to maintain higher interests rates against a debtor the purchaser should endeavor to pay less than the entire tax debt when purchasing the lien because fully payment may be seen as extinguishing the underlying debt. Additionally, the purchaser should include in the purchase agreement language which would ensure a continuity of rights between the municipality and the

⁶² *Id.* at 804.

⁶³ *See Id.*

⁶⁴ *See Id.* at 805.

private entity. Further, the purchase agreement may also contain provisions which indicate that the purchase has not extinguished the underlying debt. Explicit language in purchase agreements may reduce challenges by debtors and lead to quicker results in courts. Finally, if the two factors have been satisfied, a debtor will be barred from “cramming down” the interest rate and a plan that proposes a reduced rate for tax liens will be successfully challenged by the purchaser. As a result section 511(a) will be applicable and the interest rate applied will be the non-bankruptcy rate.

This line of cases also has significant implications for debtors who owed delinquent taxes and puts increased pressure on such debtors. Since most courts have granted purchasers of tax liens the anti-modification protection under section 511(a), a debtor will likely be forced to carry higher rate of interest on the tax. In particular, the debtors will not be able to reduce the interest rate on the tax liens under *Till*. As a practical matter, this means that the debtor will be required to pay more money to the purchaser of the tax lien under the debtor’s plan because the debtor likely be paying interest at a double-digit rate under the applicable statute as opposed to a relatively low interest rate had *Till* applied.

Conclusion

The sale of tax liens will continue to create litigation in the bankruptcy courts as purchasers attempt to enforce higher interest rates on those liens while debtors struggle to reduce the interest rates under *Till*. Courts must address first, whether a purchaser is a creditor and second, whether the purchaser has a tax claim. In order to determine if the purchaser has a tax claim, courts look to whether the purchase of tax debt extinguishes the underlying debt and whether the purchaser maintains the same rights as the municipality in relation to the debtor. While under the minority view, the court in *In re Princeton Office Park* found that the purchase

of the tax lien had extinguished the debt, the majority of other courts, including the court in *In re Debenedetto*, have found that the purchase of tax liens does not extinguish the underlying debt. Further, both minority and majority courts examine whether there has been a continuity of rights between the municipality and the purchaser. When courts have found continuity, the factor weighs heavily in favor of finding a tax claim for the purposes of section 511(a). Therefore, purchasers of tax liens should structure their purchase agreements to clearly establish that the purchase does not extinguish the debt and that there is a continuity of rights between the purchaser and the municipality.

Purchasers of tax liens will continue to face challenges to the higher interest rates unless the purchasers take account of the factors discussed by courts. If purchasers are able to satisfy the factors they will be considered holders of tax claims under section 511(a) and will receive the anti-modification protection of that section. As a result, creditors will be able to maintain their position as holders of a “tax claim” and debtors will be forced to apply the nonbankruptcy interest rates.

