

Chapman Client Alert

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Current Issues Relevant to Our Clients

New Jersey District Court Holds That a Real Estate Tax Foreclosure Sale Can Be Set Aside as a Preference under Section 547 of the Bankruptcy Code

Recently in *Hackler v. Arianna Holding Co. (In re Hackler)*,¹ the U.S. District Court for the District of New Jersey held that a real estate tax foreclosure sale² can be set aside as a preferential transfer under Section 547 of the Bankruptcy Code, thus adding to a growing number of decisions from district courts holding that foreclosure or other forced sales can be set aside.³

In *Hackler*, the unpaid municipal taxes on real property owned by the Debtors were sold at a municipal tax sale in accordance with New Jersey state law⁴ to Phoenix Funding, Inc. (“*Phoenix*”) for a premium of \$13,500. On May 9, 2016, Phoenix sold the tax sale certificate to Arianna Holding Company (“*Arianna*”). The Debtors failed to timely redeem the tax sale certificate, and on October 6, 2016, a final judgment was entered vesting Arianna with title to the property. On December 14, 2016, the Debtors filed a Chapter 13 bankruptcy petition. In their petition, the Debtors scheduled the property as being valued at \$335,000, and Arianna’s judgment lien as worth \$45,000.⁵ The Debtors then commenced an adversary proceeding against Arianna seeking to avoid the October 6, 2016 transfer of the property to Arianna as a constructively fraudulent transfers under 11 U.S.C. § 548 (“*Section 548*”), or alternatively, as an avoidable preference under 11 U.S.C. § 547 (“*Section 547(b)*”).⁶

The Debtors eventually filed a motion for summary judgment on their adversary complaint, which the bankruptcy court denied as to the Section 548 fraudulent transfer claim but granted as to the Section 547(b) preference claim. On appeal, the District Court affirmed the bankruptcy court’s ruling, finding that Arianna had essentially conceded that all elements of a preference were present, in part because it would recover \$335,000 in property in exchange for a \$45,000 debt — thus realizing far more than the \$45,000 that it would otherwise be paid under Chapter 7 of the bankruptcy code.⁷ The District Court also observed that while foreclosure sales require public bidding based on the value of the property, tax certificate bids are calculated based on the accrued taxes and interest thereon, not the value of the property. As such, a New Jersey tax certificate sale is akin to a strict foreclosure, which does “not result in a public sale, but a ‘straight transfer of title.’” Because the Debtors satisfied all five elements of their Section 547 claim, the Court allowed the Debtors to set aside the transfer of the property to Arianna.

Hackler provides debtors with another means to recover real property in a bankruptcy proceeding that might otherwise be lost to a real estate tax purchaser by operation of applicable state law governing the sale of delinquent real estate taxes. However, it is noteworthy that *Hackler* specifically relied on Section 547, as other district courts have elected to follow the Supreme Court’s lead in *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994), wherein the Court held that a mortgage foreclosure rule conducted in accordance with

state law was protected from avoidance under Section 548.⁸ This split in opinions, which is due in part to differences in state law tax sale procedures, is likely to continue for the near term; the Supreme Court has of late refused to review the issue.⁹

For More Information

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- 1 *In re Hackler*, 17-CV-6589 (PGS), 2018 WL 1440326 (D.N.J. Mar. 22, 2018).
 - 2 Many jurisdictions in the U.S. have enacted statutory schemes to monetize the right to payment of delinquent real estate taxes through “tax sales.” While specific procedures vary by county and state, such tax sales typically involve third-parties engaging in competitive bidding at an annual public tax sale auction to purchase the right to payment of the real estate taxes, together with statutory interest.
 - 3 *See, e.g., In re Smith*, 811 F.3d 228 (7th Cir. 2016) (holding that Illinois real property tax sales cannot be deemed to be for “reasonably equivalent value” as a matter of law and thus can be set aside as a fraudulent transfer). *See also Seventh Circuit Holds Illinois Tax Sales May Be Set Aside as Fraudulent Transfers*, January 27, 2016, Chapman Client Alert, available [here](#).
 - 4 In a New Jersey tax sale certificate foreclosure, the certificate is sold by a municipality to a third-party at a public sale. After a two-year waiting period, the certificate holder can proceed to obtain a foreclosure judgment which vests title in the property directly in the holder without further action. *See In re McGrath*, 170 B.R. 78, 81 (Bankr. D.N.J. 1994).
 - 5 Additional judgment liens totaling \$89,000 were also recorded against the property.
 - 6 Section 547 permits a debtor to set aside a transfer of property if the transfer was (1) to or for the benefit of a creditor, (2) for or on account of an antecedent debt, (3) made while the debtor was insolvent, (4) made within 90 days prior to the filing of the petition (or up to one year, if the creditor was an insider), and (5) enables the creditor to receive more than it would if the case were under chapter 7.
 - 7 The District Court found the bankruptcy court properly denied the Section 548 fraudulent transfer claim because *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994), relied upon by Ariana, did not apply because *BFP* dealt with a mortgage foreclosure sale as a fraudulent transfer, whereas *Hackler* turned on preference law.
 - 8 *See, e.g., Tracht Gut, LLC v. L.A. Cnty. Treasurer & Tax Collector*, 836 F.3d 1146 (9th Cir. 2016); *In re Grandote Country Club Co.*, 252 F.3d 1146, 1152 (10th Cir. 2001); *In re T.F. Stone Co.*, 72 F.3d 466, 471 (5th Cir. 1995). However, other courts have declined to extend the reach of *BFP*. *See, e.g., Veltre v. Fifth Third Bank*, 562 B.R. 890 (Bankr. W.D. Pa. 2017) (declining to set aside foreclosure sale as a preference in a Chapter 11 proceeding).
 - 9 *See Smith v. SIPI, LLC*, 137 S.Ct. 103 (denying certiorari).

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