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TAX SALES: RIGHT OF PROPERTY REDEMPTION UNDER INDIANA LAW AND THE BANKRUPTCY CODE

2008

A CLE Presentation

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I. INTRODUCTION

The law regarding rights of redemption for property bought at a tax sale is of substantial importance in bankruptcy litigation. This area of law is complex, but fundamental knowledge is necessary for effective representation in the course of many debtors' bankruptcy proceedings. The right of redemption once an owner of property has filed bankruptcy is concurrently regulated by Indiana Code §§ 6-1.1-24 *et seq.* and 11 U.S.C. § 108(b). The principles involved in this area of law are well-established, both at the state and federal level.

II. TAX SALES AND THE RIGHT OF PROPERTY REDEMPTION

A. In General

In the general course of proceedings at a tax sale, a purchaser of property will receive a tax sale certificate. The owner of property purchased at a tax sale will retain a right of redemption for one year after the date of the sale under Indiana Code § 6-1.1-25-4 (the "Redemption Period"). Often, prior to the expiration of this Redemption Period, the original owner of the property will file for bankruptcy relief. In this situation, questions often arise regarding the party who properly retains the redemption interest; and more specifically, the tolling of the redemption period.

As previously stated, under Indiana law, the owner of property sold at a tax sale retains the right to redeem the property one year after the sale.¹ If at any time during the Redemption Period the owner of the property files for protection under the United States Bankruptcy Code² (the "Code"), the Redemption Period continues and is not tolled, unless it would expire within sixty (60) days from the Order for Relief (the date on which the bankruptcy petition is filed). In

¹ Indiana Code § 6-1.1-25-4. The redemption period is one hundred twenty (120) days if the purchaser is a qualified purchasing agency; if the property has been designated as unsafe and is not being used as a residence or for a business enterprise, and a metropolitan development commission believes is suitable for rehabilitation and development; or if the property was sold after a second offer of sale. For purposes of this article, we assume that the redemption period is one year. However, the same analysis would apply to property sold which has a 120-day redemption period.

² Title 11 of the United States Code.

that event, section 108(b) of the Code allows for the Redemption Period to extend for sixty (60) days from the Order for Relief.³

Subsequent to the sale, the tax sale certificate holder has an equitable interest in the property sold, subject to the execution of the owner's right of redemption. Therefore, real property sold at a tax sale should be listed in the owner/debtor's bankruptcy Schedule A with a description of such equitable interest (right of redemption), subject to the rights of the tax sale certificate holder. The tax sale certificate purchaser should be listed as a secured creditor in the schedules; therefore, the purchaser will receive notice of the bankruptcy petition and proceedings. Once the petition is filed with the Court, the owner/debtor's right of redemption becomes an asset of the bankruptcy estate. A trustee thus acquires the right of redemption. The trustee is entitled to and bound by the one year redemption right under Indiana Code, and, if applicable, the sixty (60) day extension guideline as set out in section 108(b) of the Code. In most cases, unless there is substantial equity in the real property over and above the lien of the purchaser, the trustee will abandon the redemption right, and ownership of such right will revert back to the bankruptcy debtor as the property owner. If the trustee abandons the redemption right, the owner/debtor may then exercise his/her right of redemption within the balance of one year as delineated by the Indiana Code. However, since section 108(b) of the Code only applies to the trustee, the debtor will not also retain the sixty (60) day period stated in that section once the trustee abandons the redemption right.

Indiana follows the previously stated guidelines based on the decision of *In re Tynan*, a Seventh Circuit Court of Appeals case which was based on Illinois state law.⁴ In reaching its holding in the case, the Seventh Circuit relied heavily on *Johnson v. First National Bank of Montevideo*, an Eighth Circuit Court of Appeals case.⁵ However, various other circuits have adopted approaches which differ from that of the Seventh and Eighth Circuits. This divergence in

³ 11 U.S.C. § 108(b). In most voluntary Chapter 7 and Chapter 13 cases, the Order for Relief pursuant to 11 U.S.C. § 362, also known as the Automatic Stay, is entered on the date the petition is filed with the Court. Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), the Order for Relief may not be entered if a debtor has repetitively filed bankruptcy petitions.

⁴ *In re Matter of Tynan*, 773 F.2d 177 (7th Cir 1985).

⁵ *Johnson v. First National Bank of Montevideo*, 719 F.2d 270 (8th Cir 1983).

the approaches of other jurisdictions regarding the treatment of the redemption period occurs mainly in states such as Florida and California, where the laws regarding real property differ substantially from the laws in Indiana.

The filing of a bankruptcy petition generally does not allow the owner/debtor to modify and extend the time to redeem property under Indiana law. The Indiana Court of Appeals in the 2004 case of *In re Matter of 2002 Lake County Tax Sale* held that the trial court did not have the discretion to extend the period of redemption beyond the one year statutory limit.⁶

However, two recent Indiana Court of Appeals cases have departed from previous Indiana case law which held that the Redemption Period is never tolled by the automatic stay in bankruptcy. The 2005 unreported Chapter 13 case of *In re Bankruptcy of Baker* is illustrative of the inconsistency between federal bankruptcy law and current Indiana state law. The case furthered the formerly well-established principle that 11 U.S.C. § 108(b) extends the redemption period for an additional sixty (60) days from the date of the order for relief, but “does not toll the running of the statutory redemption period beyond those initial sixty(60) days.”⁷ The case also relied upon the principle which states the automatic stay in 11 U.S.C. § 362(a)(4)-(5) does not otherwise toll the redemption period beyond that additional sixty (60) days, because “to allow the automatic stay to enlarge the redemption period beyond the additional sixty (60) days would be an impermissible enlargement of [a] [d]ebtor’s property rights.”⁸

B. Recent Developments in Indiana Case Law

The 2007 Indiana Court of Appeals case of *Dempsey v. Auditor of Marion County* represents a recent change in the law regarding the application of the Code’s automatic stay to prevent the issuance of a tax deed during a pending bankruptcy case.⁹ In *Dempsey*, the court

⁶ *In re Matter of 2002 Lake County Tax Sale of Real Property*, 818 N.E. 2d 505 (Ind. Ct. App. 2004).

⁷ *In re Bankruptcy of Baker*, Creditor, Clipper, LLC’s Brief in Support of Its Motion to Vacate and Lift the Automatic Stay, William R. Richards and Katherine A. Starks.

⁸ *Id.*

⁹ *Dempsey v. Auditor of Marion County*, 871 N.E.2d 1031 (Ind. Ct. App. 2007).

held that the county's filing of a petition for a tax deed – while the property owner's Chapter 13 bankruptcy case was pending – violated the Code's automatic stay provision, thus rendering the tax deed void.

In that case, the county executive acquired a lien on the property pursuant to Indiana Code § 6-1.1-24-6(a) since no member of the public purchased the property. According to Indiana Code § 6-1.1-24-6(b), the county executive receives a tax sale certificate and has the same rights as a public purchaser. However, when a county executive acquires a tax sale certificate, the redemption period is a shorter 120 days.¹⁰ After that time passes and the property has not been redeemed, the county executive may file a petition in the court that administered the tax sale to request the issuance of a tax deed, upon proper notice to the parties.¹¹ The court must make several findings before the tax deed can be issued, which includes a finding that “[t]he time of redemption has expired.”¹²

Prior to the decision in this case, there had been “no reported federal court decisions addressing Indiana law and whether section 362 prohibits filing a petition for a tax deed, where the tax sale occurred before a bankruptcy case is filed but such a case is filed before the redemption period expires.”¹³ Therefore, the Court of Appeal's decision heavily relied upon Illinois case law on the issue.

In reaching its decision, the court in *Dempsey* emphasized that “*Tynan* is clearly distinguishable from the present case, where the County had to take the *affirmative step* of petitioning for a tax deed before it could obtain a deed to the parcel.”¹⁴ “The affirmative step of petitioning for a tax deed also is present under Illinois tax sale law and appears to form the basis

¹⁰ Ind. Code § 6-1.1-25-4(b) (2008).

¹¹ Ind. Code § 6-1.1-25-4.6(a) (2008).

¹² Ind. Code § 6-1.1-25-4.6(b) (2008).

¹³ *Dempsey*, 871 N.E.2d at 1035.

¹⁴ *Id.* at 1036.

for the current line of cases holding that petitioning for such a deed violates the automatic stay.”¹⁵ The court also recognized that the “cases *Tynan* cited in support of its holding regarding Section 362 also specifically noted that where a mortgage foreclosure sale purchaser automatically receives title to property after the redemption period passes, then no “affirmative act” has occurred that would violate the automatic stay.”¹⁶

Therefore, the county's tax certificate (which constituted only a lien against the property) did not automatically mature into a tax deed after the statutory redemption period had passed.¹⁷ “Instead, the county was required to take the affirmative step of petitioning a trial court for a tax deed, pursuant to Indiana Code section 6-1.1-25-4.6, and to comply with all of that statute's requirements regarding notice and establishing entitlement to a tax deed.”¹⁸ That court determined that is precisely the type of activity prohibited by the Code's automatic stay provisions.¹⁹ The county's petition for the issuance of a tax deed appears on its face to be an affirmative “act to obtain possession of property of the estate or of property from the estate,” or an “act to create, perfect, or enforce any lien against property of the estate,” in violation of §§ 362(a)(3) and (4).²⁰

A similar holding was made in *ATFH Real Property, LLC v. Stewart*, a 2008 Indiana Court of Appeals decision. In that case, the owner of a tax lien brought an action to quiet title against the mortgagee after the mortgagee had foreclosed on a piece of real property within the context of his Chapter 13 bankruptcy.²¹ The Court of Appeals, relying on the decision in *Dempsey*, held that a tax sale to recover delinquent taxes conducted after the debtor had filed a petition for

¹⁵ *Id.*; see *In re McKinney*, 341 B.R. 892, 897 (Bankr.C.D.Ill.2006) (holding automatic stay precludes seeking issuance of tax deed).

¹⁶ *Id.* at 1037 (citing *Johnson v. First Nat'l Bank of Montevideo*, 719 F.2d 270, 276 (8th Cir.1983) (holding “Congress intended § 362(a) to prohibit only certain types of *affirmative actions*”).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *ATFH Real Property, LLC v. Stewart*, 879 N.E.2d 1184 (Ind. Ct. App. 2008).

bankruptcy was void as violative of the automatic stay.²² In reaching its decision, the court reasoned that the tax sale was an “act to obtain possession of property” for the purposes of section 362(a)(3).²³ Although the immediate result was not actual possession of the property, “one cannot obtain possession of property from a tax sale without first purchasing the tax lien.”²⁴ Furthermore, the court reasoned that “[a]lthough the petition for issuance of the tax deed is the act that results in actual possession, it is only the last in a series of acts, all of which are necessary.”²⁵

C. Other Developments in Case Law

The Middle District of Florida has also recently addressed issues regarding tax sales of real property. In the 2007 case *In re Millsaps*, a Chapter 7 debtor moved to avoid a judgment lien held by a tax sale purchaser of the debtor’s real property.²⁶ The court held in part that Florida’s homestead exemption did not protect the debtor’s property from a forced tax sale for nonpayment of federal taxes or purchaser’s related judgment lien pursuant to the unambiguous language of the Florida state constitution.²⁷ The applicable section of the Florida constitution states: “There shall be exempt from forced sale under process of any court, and no judgment, decree or execution shall be a lien thereon, *except for the payment of taxes and assessments* thereon . . . a homestead.”²⁸ The court also held that the debtor could not avoid the lien under section 522(f)(1) of the Code which allows for avoidance of a judicial lien impairing an exemption to which the

²² *Id.*

²³ *Id.* at 1186.

²⁴ *Id.* at 1186-87.

²⁵ *Id.* at 1187.

²⁶ *In re Millsaps*, 379 B.R. 202 (Bkrtcy.M.D.Fla.2007).

²⁷ *Id.* at 204.

²⁸ *Id.* (citing Art. X § 4 Fla. Const. (2007)(*emphasis added*)).

debtor was entitled.²⁹ Since the debtor was not entitled to the homestead exemption under the Florida constitution, section 522(f)(1) was inapplicable.³⁰

D. Calculation of Redemption Period

The general effect of Indiana Code § 6-1.1-24 *et seq.* and 11 U.S.C. § 108(b) on the right to redeem property sold at a tax sale may be demonstrated by the following example. Assume that a piece of property is sold at a tax sale on January 1, 2006. Under Indiana law, the owner now has until January 1, 2007 to redeem the property. On July 1, 2006, the owner files for bankruptcy protection. The owner/debtor's Redemption Period will end on January 1, 2007. The result is different if the property is sold at tax sale on January 1, 2006, and the owner files for bankruptcy protection on December 1, 2006. The owner/debtor's Redemption Period runs sixty (60) days from December 1, 2006 (until January 29, 2007). This results in an extension of the original one year Redemption Period under Indiana Code of 28 days. If the owner/debtor waited until December 31, 2006 to file his/her bankruptcy petition, the owner/debtor's Redemption Period would extend until March 1, 2007. This would result in an extension of the one year Redemption Period of 59 days.

III. CONCLUSION

In conclusion, both provisions of the Indiana Code and the Bankruptcy Code concurrently control the right of redemption when an owner/debtor files for bankruptcy relief. Indiana Code § 6-1.1-24 *et seq.* gives the original owner of property sold at a tax sale a one year period in which that owner may exert his/her redemption power. When an owner of such property files for bankruptcy relief, 11 U.S.C. § 108(b) extends the one year redemption period up to an additional sixty (60) days for the bankruptcy trustee. According to the recent decisions of the Indiana Court of Appeals, both a tax sale and a county's petition for the issuance of a tax deed are acts which are violative of the Code's automatic stay. These holdings represent a departure from previous

²⁹ *Id.*

³⁰ *Id.*

Indiana case law which held that the Redemption Period is never further tolled by the operation of the automatic stay in the course of a bankruptcy case. As a result of this shift in law, there is notable inconsistency between federal bankruptcy law and current Indiana state law on the issue.

Discussion Question:

In bankruptcy, subsequent to the running of the Redemption Period under Indiana law and the Bankruptcy Code, can a tax certificate holder obtain a tax sale deed without first motioning the bankruptcy court to lift the automatic stay?