

## Michigan Tax Foreclosures May Be Avoidable in Bankruptcy

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January 21, 2022

A recent opinion from the Sixth Circuit Court of Appeals has opened a new door for a taxpayer to challenge a Michigan tax foreclosure sale. The opinion held that the challenge could proceed where the property value was alleged to be substantially more than the unpaid taxes and the taxing authority effectively retained the equity of the property.

The circumstances in *Lowry v. Southfield Neighborhood Revitalization Initiative (In re Lowry)*<sup>[1]</sup> were fairly typical. A debtor owned a home in Southfield and fell behind on his property taxes. He entered into payment plans but did not make all required payments. The Oakland County Treasurer filed a petition in Michigan state court in 2016 to collect the taxes and obtained a judgment of foreclosure in February 2017. The debtor failed to redeem, and title subsequently vested with the Oakland County Treasurer. The Treasurer sold the property to the City of Southfield for \$14,496.50, which was the amount of unpaid taxes. The City quit claimed the property to Southfield Neighborhood Revitalization Initiative (SNRI) for \$1.

The debtor filed a bankruptcy petition under chapter 13 in late 2018 and sued the Oakland County Treasurer and SNRI. The debtor sought to set aside the foreclosure as a fraudulent transfer, asserting that the property had a fair market value of \$152,000 at the time of foreclosure. The bankruptcy court dismissed the case and was affirmed by the district court. The Sixth Circuit reversed.

The Sixth Circuit analyzed the U.S. Supreme Court's decision in *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994). The *BFP* case held that, in the context of mortgage foreclosures, if a state's legal process for foreclosure is followed, then the foreclosure may not be avoided as a fraudulent transfer. *BFP* expressly did not apply its holding to tax foreclosures, however. The Sixth Circuit held that *BFP*'s rationale did not apply in a circumstance where, as here, the amount of the sale price (\$14,496.50) bore no relationship to the \$152,000 value of the property.

Prior Michigan bankruptcy case law had held that a tax foreclosure could not be avoided as a fraudulent transfer.<sup>[2]</sup> Although the *Lowry* opinion was not recommended for publication and therefore is not binding, most bankruptcy courts consider unpublished Sixth Circuit opinions persuasive and tend to follow them. This opinion likely marks a change in direction for the bankruptcy courts in Michigan, and perhaps elsewhere.

This opinion might affect similar revitalization efforts where the taxing authority retains the equity for a tax foreclosed property by retaining title of the property. The Michigan Supreme Court previously held counties were not allowed to retain the sale proceeds that exceeded the taxes owed on a foreclosure property in *Rafaeli v Oakland County*. Effective January 1, 2021, the Michigan Legislature amended the tax foreclosure statute to limit the effect of *Rafaeli* by creating a mandated procedure to seek recovery of such excess proceeds. Two weeks ago, the Michigan Court of Appeals in *Procter v Saginaw County* held that *Rafaeli* applied retroactively.

The *Lowry* case might provide an avenue through bankruptcy for a claimant to recover the equity of tax delinquent property moving through (or that has been through) the tax forfeiture and foreclosure process. The holding of *Lowry* turns on the value of the property, not on the process afforded to the claimant. As a result, *Lowry* may allow challenges to a tax foreclosure even if the claimant fails to follow the new statutory process under Michigan's General Property Tax Act for recovery of surplus proceeds. Indeed, *Lowry* may permit challenges even where the property is never sold and proceeds are never generated.

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Notably, *Lowry* did not evaluate possible defenses to such a fraudulent transfer challenge; it merely decided that *BFP* and other legal doctrines did not preclude such a challenge. Thus, *Lowry* leaves municipalities with legal arguments for resisting such challenges if they should arise.

Miller Canfield advises municipalities regarding bankruptcies and many other matters. Should you have any questions or wish assistance, please feel free to contact us.

[1] Case No. 20-1712, 2021 WL 6112972 (6th Cir. Dec. 27, 2021).

[2] *In re Fisher*, 355 B.R. 20 (Bankr. W.D. Mich. 2006).