

## Michigan Tax Foreclosures in Bankruptcy – An Auction and a Right to Claim Surplus Proceeds Insulates Against Challenge as a Fraudulent Transfer

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**In January, Miller Canfield reported** on *Lowry v. Southfield Neighborhood Revitalization Initiative (In re Lowry)*<sup>[1]</sup>, an opinion from the Sixth Circuit Court of Appeals. *Lowry* held that a taxpayer in bankruptcy could challenge a Michigan tax foreclosure sale under federal bankruptcy fraudulent transfer law. The property at issue in *Lowry* was allegedly worth far more than the unpaid taxes. The taxing authority acquired the property for the taxes owed and had effectively retained the surplus.

Miller Canfield noted that *Lowry* might open the door for other challenges to tax foreclosures. A recent decision from the Bankruptcy Court for the Eastern District of Michigan, *West v. State of Michigan (In re West)*,<sup>[2]</sup> eases this concern. The facts in *West* were similar to those in *Lowry* but for two crucial differences: the property was sold at public auction, and the taxpayer had the right to claim any surplus. As previously noted, in 2020, the Michigan Supreme Court held that counties are not allowed to retain sale proceeds that exceed the taxes owed on a foreclosure property.<sup>[3]</sup> In response, effective January 1, 2021, the Michigan Legislature amended the tax foreclosure statute to create a procedure for taxpayers to claim any excess proceeds.

In *West*, a debtor bought property in Owosso for \$130,000 in 2016. He did not pay his 2018 taxes and the property was forfeited to Shiawassee County in 2020. The State of Michigan initiated foreclosure proceedings on behalf of the county. The amended tax foreclosure statute was in effect when, in 2021, a judgment of foreclosure was entered on the property. The judgment was not appealed, nor was the property redeemed. On March 31, 2021, title to the property vested in the state. In August, the property was sold at public auction for \$160,000. It seems that the debtor did not follow the required procedure to claim the surplus proceeds.

In July of 2021, the debtor filed a bankruptcy petition under Chapter 13. In December, he sued the state, the county, and the property purchasers, asserting that the foreclosure constituted a constructively fraudulent transfer under federal bankruptcy law. The *West* court noted that the property was sold at public auction and thus the price paid was presumably reasonable. The new statutory process under Michigan's General Property Tax Act provided for recovery of the surplus proceeds. The debtor "received the statutory right to claim the surplus proceeds" under the amended tax foreclosure statute, which had a value reasonably equivalent to the property forfeited. The court held that the debtor's "failure to avail himself of the opportunity to recover the surplus proceeds" did not render the foreclosure a constructively fraudulent transfer.

The holding from *West* is that a tax foreclosure is not a constructively fraudulent transfer "when a tax foreclosure sale complies with state law, and the tax foreclosure sale procedures provide at least some market forces to approximate the value of the property (i.e. competitive bidding)," and the debtor has a reasonable opportunity to claim any surplus proceeds. Although the opinion in *West* is not binding on other courts, its reasoning would be considered by other Michigan bankruptcy courts presented with the issue.

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

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

[2] Case No. 21-03039, 2022 WL 1309939 (Bankr. E.D. Mich. May 2, 2022).

[3] *Rafaeli v Oakland County*, 505 Mich. 429 (2020).