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Reversal of Fortune: Restoring Owners Equity under New Jerseys Tax Sale Law

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Amid the flurry of debate-inciting headliners from the United States Supreme Courts 2023 term, one unanimous landmark decision went largely overlooked by the public. The ruling upended the practicelong enforced by municipalities in many statesof allowing the total seizure of tax-delinquent properties, even if the owners equity in the property dwarfed the amount owed in unpaid property taxes. The new ruling, as confirmed by the New Jersey Supreme Court in January 2025, nullifies a critical aspect of New Jerseys Tax Sale Law (TSL) and materially bolsters the rights of property owners.

New Jerseys TSL, N.J.S.A. 54:5-1 to -137 (amended 2024), allows municipalities and other local taxing authorities to sell the tax debt of property owners who are behind in their property taxes (tax sales). *See Simon v. Cronecker*, 189 N.J. 304, 318 (2007). Tax sales provide municipalities with a reliable revenue stream even when property taxes go unpaid. The buyer at a tax sale receives a tax sale certificate (TSC) representing a lien on the propertysecurity for the buyers right to receive what it paid for the TSC, plus interest (the redemption amount), from the owner. The difference between the TSC purchase price and the redemption amount is the TSC buyers expected return on investment. If the property owner does not redeem the TSC within two years, the TSC buyer can begin a foreclosure action. Critically, until a 2024 landmark change in the law, a foreclosure judgment awarded the entire property to the TSC holder, even if the owner still had equity in the property worth far more than the redemption amount (surplus equity). Of course, most property owners will redeem the TSC at any cost well before a foreclosure action reaches final judgment. But, very rarely, the TSC holder buyer hits the jackpot. The notices and complaint go unheeded, the foreclosure proceedings wend their way through court without a hiccup, and the buyerwho may have spent a few hundred dollars in totalwalks away with potentially hundreds of thousands of dollars of the owners equity. Such an event, while rare, has always been a tax sale investors dream and, undoubtedly, a driving factor of the tax sale industry.

That dream was burst on May 25, 2023, when the United States Supreme Court struck down Minnesotas tax sale statute, which allowed the state to confiscate and keep an owners surplus equity to satisfy a judgment for unpaid property taxes. *Tyler v. Hennepin County*, 598 U.S. 631 (2023). The Court held that the seizure of surplus equity exceeded the lawful exercise of a states taxing power, which can only require a taxpayer to render unto Caesar what is Caesars, but no more. Therefore, keeping an owners surplus equity amounted to a taking without just compensation, in violation of the Fifth Amendment of the United States Constitution.

In *Tyler*s immediate aftermath, the New Jersey Supreme Court paused all Office of Foreclosure recommendations of final judgment in TSC cases. Meanwhile, the New Jersey Legislature scrambled to revise the TSL to comply with *Tyler*but without completely abolishing the windfall potential for TSC buyers. Instead, the amended law, which took effect July 10, 2024, allows owners to demand the return of their surplus equity from a judicial sale or internet auction, or else forfeit any claim to the surplus equity. *See* N.J.S.A. 54:5-87(b) (2024). By its own terms, the new law does not affect foreclosure judgments entered before July 10, 2024.

Tyler left two principal questions for New Jersey courts to resolve regarding the pre-amendment TSL. First, the Minnesota law permitted the *state* to seize a taxpayers surplus equity but did not authorize private purchasers to do so. Does *Tyler* only invalidate takings by the government itself like those permitted by the Minnesota statute, or also foreclosures by third-party TSC buyers? Second, what should be the fate of TSC foreclosure proceedings already pending in the courts before *Tyler* was decided?

The Appellate Division addressed both questions in *257-261 20th Ave. Realty, LLC v. Roberto*, 477 N.J. Super. 339 (App. Div. 2023). The delinquent taxpayer in *Roberto* owned several hundred-thousand dollars of equity in a property that underwent a TSC sale for unpaid taxes totaling $606. In 2021, the TSC buyer brought foreclosure proceedings. The owner neither answered the foreclosure complaint nor paid the $33,000-redemption amount, but later sought to vacate the foreclosure judgment based on exigent circumstances. The trial court vacated the judgment (subject to payment of the redemption amount), observing the Dickensian reality the TSL can create for owners who hold substantial equity in property. On appeal, the Appellate Division applied the ruling in *Tyler*which had come down while the appeal was pendingto find the TSL unconstitutional. The court explained that the seizure of surplus equity without just compensation, even by a third-party purchaser, is unlawful because the government cannot confer to a third-party a greater right than the government itself has.

Next, the court analyzed whether and to what extent *Tyler* should apply retroactively to already-pending foreclosure actions. Applying New Jersey retroactivity principles, the court held a purely prospective application of *Tyler* (to cases arising only after *Tyler* was decided) would be unfair to property owners who were already facing foreclosure. As for retroactive application, the court found it had two options: fully retroactive application even to closed cases, and pipeline retroactive application to all cases still open on direct review when *Tyler* was issued. Pipeline retroactivity offers a Goldilocks solution where a court decision announcing an important legal right would, if given full retroactive effect, cause undue hardship to parties who justifiably relied on long-standing precedent. Recognizing the substantial difficulty that full retroactive application of *Tyler* would pose for taxing authorities and TSC buyers, the court held that pipeline retroactivity struck the correct balance between protecting owners rights and the tax-paying publics interests. Pipeline retroactivity would not create the same hardship because, the court observed, until the entry of final judgment extinguishing an owners right of redemption, a tax lienholder has only an inchoate interest in a property owners equity. In addition, TSC buyers invest in tax liens knowing that most owners will redeem their properties. Thus, pipeline retroactivity is both fair and workable.

The Supreme Court of New Jersey granted certiorari and on January 9, 2025, announced its affirmance of the Appellate Divisions decision, with two important modifications. *257-261 20th Ave. Realty, LLC v. Roberto*, N.J. (2025). The Supreme Court held the pre-amendment TSL was unconstitutional pursuant to *Tyler*, explaining that TSC holders under the TSL are state actors because they perform a traditional public function the collection of taxes in concert with local governments.

As for retroactivity, the Supreme Court held that *Tyler*s ruling applies retroactively to all cases still pending on direct review, whether in federal or state court. But the Supreme Court diverged from the Appellate Division in two significant ways. First, the Supreme Court clarified, the Appellate Division incorrectly relied on retroactivity principles that New Jersey courts apply to *state court* decisions that invalidate a law under the Federal Constitution. This was the wrong rubric to analyze the retroactivity question because state court precedent can only determine the retroactive effect to be given to a state court rulingeven with respect to a question under the Federal Constitution. Under the Supremacy Clause, only federal law doctrine can determine the effect to be given to a ruling of the United States Supreme Court. Second, the New Jersey Supreme Court declined to consider whether *Tyler* should have full retroactive effectrequiring the return of all surplus equity ever foreclosed on by a TSC holder under the TSLper federal retroactivity principles. Because the appeal in *Roberto* was still pending when *Tyler* was decided, the Court had no cause to determine whether *Tyler* should be given retroactive effect even to cases no longer subject to direct review. Thus, the Supreme Court left open the question whether property owners could seek the return of, or compensation for, surplus equity they losteven years agoin a TSC foreclosure.

Another intriguing question also remains. In *Roberto*, by the time Tyler was decided, the trial courts order vacating final judgment had already restored the owners equity and relegated the TSC holder to mere lienholder status. It might be argued that the Appellate Divisions statement regarding the inchoate interests of a tax lienholder, while appropriate in *Roberto*, is less relevant where the *owner* appealed from a final judgment that was *never vacated*. Nonetheless, the United States Supreme Court itself has signaled that *Tyler* should apply retroactively to such cases on review when *Tyler* came down. *See Fair v. Contl Res.*, 143 S. Ct. 2580 (2023) (vacating tax lien foreclosure judgment, on appeal from denial of owners motion against entry of quiet title, based on *Tyler*), *vacating Contl Res. v. Fair*, 971 N.W.2d 313, 318 (Neb. 2022). Evidently, retroactive application to all cases still open on direct review means what it says.

ATTORNEYS MENTIONED

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