Separation Anxiety? Indiana Tax Sale Separates Ownership of Land and Improvements

In the Dirt: A Real Estate Legal Update

By Keith Mundrick on May 5, 2022

Can improvements to real estate, such as buildings, be owned separately from the land beneath them? This is not usual, although permissible, such as in a ground lease situation; however, a recent decision from the Indiana Court of Appeals has gone a step farther by recognizing separate real estate tax parcel numbers to improvements sold separately from the underlying real estate. The following case presents a cautionary tale for Indiana landowners in a ground lease scenario, and for any lender secured by land subject to a ground lease.

In *Elda Corp. v. Holliday, LLC*, the court recognized that "fee simple" title to improvements can be severed and conveyed separately from the land beneath those improvements by creation of a separate tax parcel. 171 N.E.3d 124 (Ind. Ct. App. 2021), *trans. denied* 173 N.E.3d 1024 (Ind. 2021). The court further held that once the separate "improvements parcel" was conveyed to a new owner by a tax deed, the owner of the land beneath the improvements had no right to ejectment, rent, or damages from the owner of the improvements.

Elda Corp. v. Holliday, LLC

Elda Corp. was the owner of land in Madison County, Indiana. In 1963, Elda granted a ground lease to a real estate investment trust that included buildings and paved parking areas, which the court referred to as the "Improvements Parcel." From the beginning, the Improvements Parcel was identified separately and had its own unique property tax parcel number.

The trust operated a shopping mall on the property, and subsequently transferred its interest in the ground lease to a new mall operator, who failed to pay property taxes on the Improvements Parcel. The Improvements Parcel ***only*** went up for tax sale. Elda never challenged the tax sale and did not pay the delinquent taxes for the Improvements Parcel.

A buyer purchased the Improvements Parcel at a tax sale and transferred the sale certificate to Holliday, LLC. The tax sale certificate noted that the purchase was for "Improvements ONLY," and the tax deed ultimately granted "an estate in

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fee simple, free and clear of all liens and encumbrances created or suffered before or after the tax sale." Once the tax deed was issued, Elda demanded that Holliday either agree to the terms of the previous ground lease or vacate the premises. The parties then sued to decide the issue.

The trial court concluded that the Improvements Parcel was "severed" and taxed separately from the land, and that Holliday was the "fee simple owner" of the Improvements Parcel because Elda failed to challenge the tax sale and did not pursue any redemption rights. *Id.* at 127. Thus, the trial court determined that Elda had no right to eject Holliday from the land or collect rent for Holliday's exercise of its rights under the Improvements Parcel.

Elda appealed the decision, but the Court of Appeals affirmed the result: "Holliday has title to the Improvements Parcel in fee simple, free and clear of all encumbrances including the prior ground lease, and its ownership of the Improvements Parcel does not amount to a wrongful possession of the Land. Although Elda could have prevented such a result at various times before and after the tax sale, it did not." *Id.* at 130-31.

The court compared the ownership of improvements to an easement or to mineral rights: "This court has recognized that an 'improvements only' title holder may enjoy the rights to his property without trespassing upon the enjoyment rights of the title holder of the land." *Id.* The court also relied upon the Indiana Tax Code, which provides that a tax deed "vests in the grantee an estate in fee simple absolute." *Id.*

The court found significant that at oral argument on summary judgment, counsel for Elda *agreed* that the tax deed terminated the prior ground lease by operation of law. Thus, the court noted that Elda "abandoned any potential privity of estate argument and that the ground lease was a covenant running with the land. ELDA has not argued that the ground lease runs with the land…." Had this argument not been abandoned, the case might have turned out differently. The outcome of the decision awards the tenant with a windfall, converting its periodic, limited tenancy, into a rent-free perpetual tenancy. This outcome is avoided if the ground lease survives the tax sale foreclosure.

Elda then sought transfer to the Supreme Court of Indiana, which was denied.

Lessons and Consequences after Elda Corp.

The potential consequences of *Elda* are concerning. In that case, there now exist two distinct parcels, with each owner holding a fee simple interest in realty according to the Indiana Court of Appeals. Elda cannot restrict Holliday's access to the improvements, eject Holliday, or charge rent to Holliday. Elda is left with a severely restricted piece of land, with little recourse other than to sell its interest to Holliday.

This result seems to run against certain well-established principles of real estate law. Fortunately, the outcome seen in *Elda* seems to be a function of the specific facts of that case. Although parties to a lease have the contractual right to determine responsibility for taxes, the creation of a separate tax parcel by the county is what led to the conundrum seen here. Once title was obtained from a tax sale, Indiana law required a tax deed vesting “an estate in fee simple absolute, free and clear of all liens and encumbrances” to Holliday. All “liens and encumbrances” included the ground lease.

How common is the practice of establishing a separate tax parcel for improvements only? According to many county assessors’ offices, the issuance of separate tax parcels for improvements has fallen out of favor. However, “Improvements Parcels” still exist, so Indiana landowners must exercise caution.

Ultimately, Elda’s failure to take action in response to the tax sale is what led to its predicament. Lessors must be alert to whether a separate tax parcel exists for the improvements on any ground lease, and must also be prepared to act in the event that a lessee falls behind on taxes for an “improvements parcel.” It is better to advance payment for delinquent taxes than to risk the improvements going to a tax sale and wiping out the ground lease.

Lenders should also take notice of this case. If a bank had made a loan to Elda that was secured by a mortgage on Elda’s land, the value of the bank’s collateral would be severely compromised by the issuance of the tax deed to Holliday for the Improvements Parcel. Furthermore, the tax sale effectively terminated the ground lease, which presumably would have been the primary source of repayment on this hypothetical loan. Accordingly, the lender’s title review process must seek to identify any separated tax parcel when mortgaged land is subject to a ground lease.