



House
Legislative
Analysis
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IMPLEMENT ASSESSMENT CAP

House Bill 5945 as enrolled
Public Act 415 of 1994
Second Analysis (1-9-95)

Sponsor: Rep. Bill Bobier
House Committee: Taxation
Senate Committee: Finance

THE APPARENT PROBLEM:

One of the features of Proposal A, the ballot proposal that overhauled Michigan's school tax collection and distribution system, is a constitutional amendment to limit how fast property assessments can grow. Beginning with taxes levied for 1995, the assessment of any parcel cannot increase from one year to the next by more than the rate of inflation or five percent, whichever is less, until ownership of the property is transferred. Upon transfer, the property would be re-assessed based on market value (or "true cash value"). Legislation is required to implement the assessment cap. A number of complicated issues are involved.

For example, the constitution now refers to "the taxable value of each parcel of property." This new concept of "taxable value" needs to be fleshed out in statute. Typically, property has been assessed for tax purposes based on market value; the millage rate is applied to the state equalized valuation (SEV), which is supposed to be set at 50 percent of market value. But with the assessment cap in place, a parcel of property will have both a state equalized valuation and a taxable value, which might or might not be the same amount. Property whose value is increasing faster than the rate of inflation will, due to the cap, have a taxable value below (perhaps, over time, far below) state equalized valuation. Upon its sale or other transfer of ownership, the property's taxable value and SEV would be the same until the cap was applied once again. This also raises the question of what, for the purposes of lifting the cap and re-assessing property, constitutes a transfer of ownership. What sorts of transactions should not constitute a transfer for these purposes? Tax specialists from the legislature and the treasury department, and representatives of other interested parties, have been working to answer these and other thorny questions that arise in implementing

the assessment cap approved by voters on March 15.

THE CONTENT OF THE BILL:

The bill would amend the General Property Tax Act to implement the new provision in the state constitution that limits how much property assessments can increase from one year to the next. The new constitutional provision reads as follows (with emphasis added).

For taxes levied in 1995 and each year thereafter, the legislature shall provide that the taxable value of each parcel of property adjusted for additions and losses, shall not increase each year by more than the increase in the immediately preceding year in the general price level . . . or 5 percent, whichever is less until ownership of the parcel of property is transferred. When ownership of the parcel of property is transferred as defined by law, the parcel shall be assessed at the applicable proportion of current true cash value.

The bill would put into the General Property Tax Act, for the purposes of the assessment cap, definitions of "taxable value", "additions", "losses", and "transfer of ownership". Those definitions are described in detail later.

The bill also would specify that the taxable value of personal property located on a parcel of real property and assessed to the same person would be calculated separately from the calculation of taxable value of real property and that the taxable value of buildings on leased land (which are considered personal property) would be calculated separately from the taxable value of other personal property assessed to the same person. (This would not

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prohibit the filing of personal property statements combining personal property located on more than one parcel of real property.)

The bill would make use of the term "taxable value" (and "tentative taxable value") throughout the assessment and equalization provisions of the act, often using it instead of "state equalized valuation" and sometimes in addition to it. Taxes would be levied based on the taxable value of a parcel of property and not the state equalized value, for example, and the bill would make the act reflect that. A local unit's assessment roll would still have to contain the estimate of true cash value and assessed value of each parcel of real property, but would also contain the tentative taxable value and the date of the last transfer of ownership. The notice to owners of assessment increases would have to include, in addition to information currently required regarding the assessment, the current taxable value, the taxable value in the preceding year, the difference between the two, the inflation rate for the immediately preceding year, and a statement provided by the state tax commission explaining the relationship between state equalized valuation and taxable value. Further, if the assessor believed a transfer of ownership had occurred in the immediately preceding year, the statement would say ownership had been transferred and that the taxable value of the property was the same as the SEV.

The register of deeds of the appropriate county would be required to notify the assessing officer of the local taxing unit at least once per month of any recorded transaction involving the ownership of property. Except in certain specified cases, the buyer, grantee, or other transferee of the property would have to notify the appropriate assessing office of the transfer of ownership within 45 days of the transfer, the date of the transfer, the actual consideration of the transfer, and the property's parcel identification number or legal description. (This would not apply to personal property except for certain specified buildings, leasehold improvements and structures, and leasehold estates.) If the buyer, grantee, or transferee did not notify an assessing officer as required, all of the following could be levied: any additional taxes that would have been levied if the transfer of ownership had been recorded as required from the date of transfer; interest and penalty from the date the tax would have been originally levied; and a penalty of \$5 per day for each separate failure, up to \$200.

(This last penalty could be waived by resolution of a local governing body.)

The concept of taxable value would also be used in determining the millage rollbacks that are required, generally speaking, when property tax revenues from existing property increase at a rate faster than inflation (the Headlee rollback). The constitutional provision says: "If the assessed valuation of property as finally equalized, excluding the value of new construction and improvements, increases by a larger percentage than the increase in the General Price Level from the previous year, the maximum authorized rate applied thereto in each unit of Local Government shall be reduced to yield the same gross revenue from existing property, adjusted for changes in the General Price Level, as could have been collected at the existing authorized rate on the prior assessed value." The bill specifies that the term "assessed valuation of property as finally equalized" refers to taxable value. (This means the increase in taxable value would be the determinant of whether millages would have to be decreased.)

Definition of "Taxable Value". For taxes levied in 1995 and thereafter, the taxable value of each parcel of property would be the lesser of:

- a) the property's current state equalized valuation; and
- b) the taxable value in the immediately preceding year, minus any losses, multiplied by the inflation rate or five percent, whichever was less, plus all additions.

However, if a fraction, the numerator of which is the SEV for the current year minus additions and the denominator of which is the SEV for the immediately preceding year minus losses, was less than both 1.05 and the inflation rate, then the property's taxable value would be the product of the taxable value in the immediately preceding year minus losses, multiplied by that fraction, plus additions.

(For taxes levied in 1995, the property's taxable value in the immediately preceding year would be the property's SEV in 1994.)

Upon a transfer of ownership of property after 1994, the property's taxable value for the calendar year following the year of the transfer would be the property's SEV for the calendar year following the

transfer. If the taxable value was adjusted due to a transfer of ownership, a subsequent increase in taxable value would be subject to the cap.

Definition of "Transfer of Ownership". The term "transfer of ownership" would mean the conveyance of title to or a present interest in property, including the beneficial use of the property, the value of which was substantially equal to the value of the fee interest. The term would include, but not be limited to:

-- a conveyance by deed.

-- a conveyance by land contract. The taxable value would be adjusted for the calendar year following the year in which the contract was entered into and would not be subsequently adjusted when the deed conveying title was recorded.

-- a conveyance to a trust after December 31, 1994, except if the sole present beneficiary or beneficiaries were the settlor or the settlor's spouse, or both.

-- a conveyance by distribution from a trust, except if the distributee was the sole present beneficiary or the spouse of the sole present beneficiary, or both.

-- a change in the sole present beneficiary or beneficiaries of a trust, except a change that adds or substitutes the spouse of the sole present beneficiary.

-- a conveyance by distribution under a will or by intestate succession, except if the distributee was the decedent's spouse.

-- a conveyance by lease if the total duration of the lease, including the initial term and all options for renewal, was more than 35 years or the lease granted the lessee a bargain purchase option. This would not apply to personal property except for certain specified buildings, leasehold improvements and structures, and leasehold estates. (A bargain purchase option would be defined as the right to purchase the property at the termination of the lease for not more than 80 percent of the property's projected true cash value at the termination of the lease.) After December 31, 1994, the taxable value of property conveyed by lease with a duration of more than 35 years or with a bargain purchase option would be adjusted for the calendar year in which the lease is entered into.

-- a conveyance of an ownership interest in a corporation, partnership, sole proprietorship, limited liability company, limited liability partnership, or other legal entity if the ownership interest conveyed was more than 50 percent of the entity. The entity would be required to notify the assessing officer on a form provided by the state tax commission not more than 45 days after a transfer unless notification was provided by certain other parties.

-- a transfer of property held as a tenancy in common, except that portion of the property not subject to the ownership interest conveyed.

Transfer of ownership would not include the following:

-- the transfer of property from one spouse to the other or from a decedent to a surviving spouse.

-- a transfer from a husband, a wife, or a husband and wife, creating or disjoining a tenancy by the entireties in the grantors or the grantor and spouse.

-- a transfer subject to a life estate or life lease retained by the transferor, until expiration or termination of the life estate or life lease.

-- a transfer through foreclosure or forfeiture of a recorded instrument (under chapters 31, 32, or 57 of the Revised Judicature Act) or through deed or conveyance in lieu of a foreclosure or forfeiture, until the mortgagee or land contract vendor subsequently transferred the property. If the property was not again transferred within one year of the expiration of any applicable redemption period, the property's value would be adjusted.

-- a transfer by redemption by the person to whom taxes were assessed or property previously sold for delinquent taxes.

-- a conveyance to a trust if the sole present beneficiary of the trust was the settlor or the settlor's spouse.

-- a transfer pursuant to a judgment or order of a court of record making or ordering a transfer, unless a specific monetary consideration was specified or ordered by the court for the transfer.

-- a transfer creating or terminating a joint tenancy between two or more persons if at least one was an original owner of the property when the joint

tenancy was initially created and, if the property was held as a joint tenancy at the time of conveyance, at least one of the persons was a joint tenant when the joint tenancy was initially created and had remained a joint tenant ever since. A joint owner at the time of the last transfer would be an original owner of the property. (Also, a person would be an original owner of property owned by that person's spouse.)

-- a transfer for security or an assignment or discharge of a security interest.

-- a transfer of real property or other ownership interests among members of an affiliated group (meaning one or more corporations connected by stock ownership to a common parent corporation). Upon request by the state tax commission, a corporation would have to furnish proof a transfer met this definition. Failure to do so could result in the penalties referred to above for failing to notify an assessing officer of a transfer of ownership.

-- normal public trading of shares of stock or other ownership interests that, over any period of time, cumulatively represent more than 50 percent of the total ownership interest in a corporation or other legal entity and were traded in multiple transactions involving unrelated individuals, institutions, or other legal entities.

-- a transfer of real property or other ownership interests among legal entities if the entities involved were commonly controlled. Proof would have to be furnished upon request by the state tax commission with penalties for failure to do so.

-- direct or indirect transfer of real property or other ownership interests resulting from a transaction that qualified as a tax-free reorganization under section 386 of the federal Internal Revenue Code. Proof of compliance would have to be provided upon request, with penalties for failure to do so.

Definitions of "Additions" and "Losses". For taxes levied after 1994, the term "additions" would refer to:

-- omitted real property, meaning previously existing tangible real property not included in the assessment. Omitted property could not increase taxable value as an addition unless the assessing jurisdiction had a property record card or other documentation showing that the omitted real

property had not been previously included in the assessment. Omitted property for the current and the two immediately preceding years, discovered after the assessment roll was completed, could be added to the tax roll. The value of omitted property would be based on its taxable value had it not been omitted.

-- omitted personal property.

-- new construction. The value of new construction would be 50 percent of true cash value.

-- previously exempt property, which would be valued at 50 percent of true cash value, unless it had been subject to a so-called poverty exemption, in which case, taxable value would be used in the calculation. The taxable value of a property that had previously been exempt (i.e., was no longer exempt) as a "new facility" under the act granting industrial facility exemptions would be the taxable value that the property would have had if it had not been exempt.

-- replacement construction, which means construction replacing property damaged or destroyed by accident or act of God where the construction's true cash value did not exceed the true cash value of property damaged or destroyed in the immediately preceding three years.

-- an increase in taxable value due to the complete or partial remediation of environmental contamination. The degree of remediation would be determined by the Department of Natural Resources.

-- an increase in the property's occupancy rate if 1) a loss had previously been allowed due to a decrease in occupancy or 2) if the value of new construction had been reduced because of a below-market occupancy rate.

-- public services, such as water service, sewer service, a primary access road, natural gas service, electrical service, telephone service, sidewalks, or street lighting. (For purposes of determining taxable value of real property, the value of public services is the amount of increase in the property's true cash value attributable to the available public services.)

Additions would not include increased value attributable to: platting, splits, or combinations of

property; a change in zoning; and, for the purposes of the calculation of the Headlee millage reduction process only, increased taxable value after a transfer of ownership of property.

For taxes levied after 1994, the term "losses" would mean all of the following:

- property that had been destroyed or removed.
- property previously subject to tax that was now exempt.
- an adjustment in value because of a decrease in occupancy rate, to the extent provided by law.
- a decrease in taxable value attributable to environmental contamination existing on the immediate preceding tax day, with the degree of contamination to be determined by the DNR.

Losses would not include decreased value attributable to either platting, splits, or combination of property or a change in zoning.

Homestead Affidavit. The bill also would amend a portion of the act dealing with the homestead affidavit that must be filed for an owner-occupied principal residence to obtain an exemption from local school taxes. The act requires that a person who prepares a closing statement for the sale of property provide affidavit and rescission forms to the buyer and seller and, if requested by the buyer or seller, file the forms with the local tax collecting unit. The bill specifies that if the forms were not provided or not filed as requested, then the buyer could appeal to the Department of Treasury within 30 days of being notified that an exemption was not recorded. If the department determined the buyer qualified for the exemption, the department would notify the local assessor and the tax roll would be corrected. The provision specifies that it would not create a cause of action at law or in equity against a closing statement preparer who failed to provide forms or file forms when requested.

State Jurisdiction Over Local Tax Roll. The act provides that if a local assessing district does not have an assessment roll that has been certified by a qualified certified assessing officer, the state tax commission must assume jurisdiction over the assessment roll and provide for the preparation of a certified roll. The bill would also require such state jurisdiction if a certified assessor was not in

substantial compliance with the act.

MCL 211.10 et al.

FISCAL IMPLICATIONS:

There is no specific information at present. It should be noted that the legislation is an effort to make statute conform to and implement a new provision in the constitution.

ARGUMENTS:

For:

The bill represents the work of tax specialists from the legislature and the Department of Treasury and aims at the effective and equitable implementation of the assessment cap that was added to the constitution with the passage of Proposal A. The implementation requires a number of fairly complicated and technical amendments to the statute that specifies how the value of property is to be determined for the purpose of the state's property tax system. The system will now have to deal with the notion of a taxable value of property that is often different from the market value-based assessments that were previously used. And the taxable value of property will depend, in part, on how recently its ownership had been transferred. While adjustments will no doubt be needed to the assessment cap provisions in the future, as various flaws and unintended consequences are revealed, this bill provides a widely agreed upon set of implementing provisions.

Response:

It should be noted that using the concept of taxable value for determining millage rollbacks will be harmful to those older municipalities where there is little new building. The increase in tax base that would otherwise occur when homes are sold and re-assessed will be offset by the triggering of a millage rollback. The assessment cap will already put a strain on local public finances.

Against:

Some people have argued that if a person buying property on a land contract defaults and the person holding the contract gets the property back as a result, the taxable value of the property should go back to the pre-contract level as if the contract had never existed. Underlying this is the notion that ownership of property was never transferred in such a case. Why should the property owner be

penalized (by losing the assessment cap) when a land contract default occurs?

Response:

The bill would treat a conveyance of property by land contract as a transfer of ownership. So, at that point, the assessment cap on property would come off and the property would be revalued. If the original owner got the property back due to default, that would not be considered a transfer of ownership and the property would not be revalued due to the default. The property would be revalued if it was then held without a new transfer for more than one year. This seems fair enough. To have property sold under a land contract return to a taxable value attributable to the assessment cap from before the contract began is overgenerous. A contract default could occur after a decade or more of payments! Property taxes have already been cut substantially, especially for agricultural property (for which land contract transactions are said to be common).