Legislative Analysis

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POP-UP EXEMPTION FOR FIRST-TIME HOME BUYERS IN MICHIGAN

House Bill 5987 (Substitute H-1)
Sponsor: Rep. Virgil Smith
Committee: Commerce
First Analysis (6-29-04)

BRIEF SUMMARY: The bill would allow local units of government to elect to retain the assessment cap on owner-occupied residential property when the property was transferred to a buyer who was a first-time home buyer in Michigan.

FISCAL IMPACT: This bill would reduce State education tax and property tax revenue by an indeterminate amount. The fiscal impact would depend on the local units that participate, the value of the property involved, and the millage rates.

THE APPARENT PROBLEM:

Generally speaking, the increase in the assessment of a parcel of real property cannot increase from one year to the next by more than the rate of inflation or five percent, whichever is less. However, when property is transferred, its valuation returns (or "pops up") to 50 percent of market value. At that point, the assessment cap is once again applied, this time to the readjusted assessment. These assessment cap provisions were part of Proposal A, the new school financing system adopted by voters in 1994. Some transactions are exempt from being treated as pop-up transfers under the General Property Tax Act. (See Background Information for further discussion of the assessment cap.) Prior to Proposal A, property taxes were based on state equalized valuation or SEV, which was defined as 50 percent of true cash value. Since then, taxes are based on taxable value, which essentially is the SEV adjusted by the cap on assessment increases. One result is that owners of similar homes pay different amounts in property taxes.

The assessment cap and pop-up together mean, obviously, that when a home is sold, the new buyer will face a larger property tax bill than the old owner, assuming the home is increasing in value. According to the Michigan Citizens Research Council, the gap statewide between taxable value and state equalized valuation is about 78 percent using 2003 data. Some people believe the "pop-up" results in "sticker shock" for new owners caught unawares. It may also discourage some homebuyers from acquiring previously owned homes (rather than newly built homes), with the result that these residences stay on the market longer. Critics suggest the additional taxes are particularly a problem for first-time home buyers.

One way to address this problem would be to allow local units to keep the assessment cap on owner-occupied residences when they are transferred.

THE CONTENT OF THE BILL:

The bill would amend the General Property Tax Act to allow a local unit of government to continue the assessment cap when owner-occupied residential property is transferred if the property was being transferred to a person who had not previously claimed a principal residence exemption in any local tax collecting unit in the state (e.g., a first-time home buyer in Michigan).

For this to occur under the bill, the governing body of the local tax collecting unit would have to adopt a resolution approving the retention of the property's taxable value after the transfer of the property.

Specifically, the bill would amend a section of the act that lists transactions that do not count as transfers of ownership for the purpose of re-assessing transferred property at 50 percent of its true cash value (that is, making the property's taxable value equal to its state equalized value).

To qualify, the new owner would have to file an affidavit claiming the property as his or her principal residence, and the local tax collecting unit would have to agree that the property qualified as an owner-occupied principal residence by granting the exemption. (An owner-occupied principal residence is exempt from paying local school operating property taxes.)

MCL 211.27a

BACKGROUND INFORMATION:

The Citizens Research Council published in March 2001 a memorandum entitled The Growing Difference Between State Equalized Value and Taxable Value in Michigan. The CRC also has updated data on the gap between SEV and taxable value on a county by county basis. It describes Michigan's property tax system as a "modified acquisition value system", in which property is taxed based on its value at the time of acquisition. The information can be found on the CRC web site at www.crcmich.org.

ARGUMENTS:

For:

Proponents of this approach say it has the following benefits: 1) it will reduce housing costs for first-time homebuyers through lower property taxes; 2) it will reduce "sticker shock" for homebuyers in areas where there is a large difference between taxable value and state equalized valuation, which tend to be areas with lower residential turnover rates or slower growth; 3) it could help real estate sales in areas where homes are remaining on the market for extended periods of time, particularly older homes in more expensive urban neighborhoods; 4) it will be a step towards reducing the current inequality where owners of homes with similar market value pay different tax rates based on longevity of ownership; and 5) it is a local option, requiring the approval of the local tax collecting unit for the program to be implemented.

Against:

Critics of this approach, some of whom agree that problems associated with the assessment cap and pop-up will soon have to be addressed, raise the following points: 1) the current "problem" is exactly what the people voted for in approving Proposal A ten years ago; 2) Proposal A significantly reduced property taxes for owner-occupied residences, and taxes for newly purchased homes (even with the assessment pop-up) remain substantially below what they would have been without Proposal A; 3) while the legislature is free to define the term "transfer" for the purpose of providing exemptions from the pop-up, existing exemptions do not discriminate the way this bill would, singling out one category of homebuyers for special treatment and allowing the special treatment to be inconsistently applied throughout the state; 4) technically, the bill applies not to first-time homebuyers, but to people buying their first owner-occupied residence in Michigan, meaning that people moving into a neighborhood from another state (no matter how many previous homes they had owned) would get preferential treatment over those moving into the same neighborhood from elsewhere in the state; and 5) it will reduce revenues for schools and other public services at a time when budgets are already in dire straits, and moreover, it allows one local unit alone to make that decision while affecting other governmental entities.

POSITIONS:

The Michigan Association of Homebuilders indicated support for the concept to the House Commerce Committee. (6-22-04)

The Department of Treasury opposes the bill. (6-22-04)

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