Legislative Analysis

Mitchell Bean, Director
Phone: (517) 373-8080
http://www.house.mi.gov/hfa

TAXATION OF COMMERCIAL RENTAL PROPERTY

House Bills 4456 and 4457
Sponsor: Rep. Vincent Gregory
Committee: Tax Policy

Complete to 4-28-09

A SUMMARY OF HOUSE BILLS 4456 AND 4457 AS INTRODUCED 2-24-09

The bills attempt to address an issue stemming from the Michigan Supreme Court's 2002 decision in *WPW Acquisition v. City of Troy* concerning the role of "occupancy additions" in determining the taxable value of commercial rental property. Generally speaking, under current law, the taxable value of commercial rental property can be reduced because of a decrease in occupancy rate but cannot increase when the occupancy rate subsequently increases.

House Bill 4457 would create a new act imposing a specific tax on commercial rental property that allows for increases and decreases in taxable value based on changes in occupancy rates, and House Bill 4456 would exempt commercial rental property that is subject to the new specific tax from general ad valorem property taxes. Essentially, commercial rental property would then be subject to the new specific tax rather than the standard property tax.

House Bill 4456 - General Property Tax Exemption

The bill would exempt commercial rental property from the General Property Tax Act if the owner previously claimed an occupancy loss under the act and filed an affidavit with the local tax collecting unit claiming an exemption. The affidavit would have to be filed by (1) the December 31 of the year immediately after the year in which the bill becomes effective for property currently in existence; (2) the December 31 of the year in which newly constructed property is issued a certificate of occupancy; or (3) the December 31 of the year immediately following a year in which a transfer of ownership occurred, if an exemption was not previously claimed. Property owners would be required to file a form rescinding an exemption within 90 days when the property is no longer commercial rental property. Failure to file a rescission would be subject to penalty of $5 per day, up to $200, for each day after the 90-day period. The penalty would be deposited into the School Aid Fund. The Department of Treasury would have the authority to waive the penalty.

Assessors could deny an exemption claim if they believe the property is not commercial rental property. A denial could be appealed to the State Tax Commission. If an exemption is denied, the tax roll would be amended to reflect the denial and a new tax roll would be issued. Taxes levied would be delinquent on March 1st of the year immediately after the year in which the corrected tax bill is issued. If the property is

transferred to a bona fide purchaser before a corrected bill is issued, the tax would not be a lien against the property and would not be billed to the purchaser, but would be assessed against the previous owner who claimed the exemption.

In addition, the bill would amend current law concerning occupancy losses and additions (MCL 211.34d) to specify that an occupancy addition may be taken prior to January 1, 2005 and that an occupancy loss may be taken prior to December 31, 2007. However, if the adjustments for occupancy losses and additions under HB 4457 are invalidated by a court, occupancy losses could still be taken (in effect, current practice would still prevail - that is, the ability to take occupancy losses without occupancy additions).

House Bill 4457 - Commercial Rental Property Specific Tax

Under the bill, local assessors each year would be required to determine the value and adjusted taxable value of a parcel of commercial rental property by December 31st. Property would be assessed at 50 percent of its true cash value. In general, the adjusted taxable value of the property would be the lesser of the following:

- Current state equalized value (SEV).
- Adjusted taxable value in the immediately preceding year, adjusted for any losses and any occupancy loss, multiplied by five percent or the rate of inflation, and adjusted for any additions and any occupancy addition.

For 2010, a property's adjusted taxable value in the immediately preceding year would be the sum of (1) the taxable value the property would have had in 2010 if the property had been subject to general ad valorem property taxes and (2) any addition that would have been attributable to an increase in occupancy rate occurring after January 1, 2005 and before the bill's effective date, notwithstanding the state Supreme Court's *WPW* decision.

Beginning in 2010, if a property's taxable value is adjusted to reflect an occupancy loss, the property owner would have to file, by January 15th, a copy of the rent roll or a sworn statement if the square footage of occupancy as of the immediately preceding December 31st. After 2010, when a property is sold, its adjusted taxable value would "pop-up" to the state equalized value, and would then be subject to the assessment cap until the next transfer of ownership. Assessments could be appealed in the same manner as provided under the General Property Tax Act. The act further specifies that this would not limit a property owner's right to appeal under the Tax Tribunal Act, General Property Tax Act, or the Revenue Act.

The tax rate would be the number of mills assessed in the local tax collecting unit as if the property were subject to the General Property Tax Act, and the base would be the adjusted taxable value. The tax would be payable in the same manner as taxes collected under the General Property Tax Act. Property located within a renaissance zone would be exempt from the specific tax, except for special assessments, debt millages, school enhancement millages, and school building sinking fund millages.

Tax revenue would be disbursed by the tax collecting unit to other taxing units in the same manner as provided under the General Property Tax Act. Unpaid taxes would be subject to foreclosure, forfeiture, and sale in the same manner as provided under the General Property Tax Act.

The act would be repealed if the adjustments for occupancy losses and additions are found by a court of competent jurisdiction to be invalid and no longer under appeal.

FISCAL IMPACT:

For similar bills in the 2007-08, it was estimated that the School Aid Fund (SAF) would increase by $5 million ($1.25 million in State Education Tax revenue and a decrease in expenditures of $3.75 million). In addition, local property tax revenue was estimated to increase by $5.8 million. These estimates have not yet been updated to reflect current economic conditions.

BACKGROUND INFORMATION:

Under the State Constitution, as amended by Proposal A of 1994, year-to-year increases in the taxable value of a parcel of property are generally limited to five percent or the rate of inflation, whichever is lower. However, the value of property may be adjusted for certain additions and losses, irrespective of the assessment cap. Under the General Property Tax Act, the term "losses" includes, among other things, an adjustment in value because of a decrease in a property's occupancy rate. Similarly, the term "additions" includes an increase in the value attributable to an increase in the property's occupancy rate if a loss was previously allowed because of a decrease in occupancy rate of if the value of new construction had been reduced because of a below-market occupancy rate.

In *WPW Acquisition v. City of Troy* (466 Mich 117), the Michigan Supreme Court held that the additional value attributable to an increase in a property's occupancy rate was not consistent with Proposal A, and therefore was unconstitutional.[1] At the time Proposal A was approved by voters, the terms "additions" and "losses," as defined in the General Property Tax Act, did not encompass any increase or decrease in value attributable to a change in occupancy rate. The current definitions, as applied to tax years after 1994, were added to the General Property Tax Act with the enactment of Public Act 415 of 1994, an act implementing Proposal A. The court noted that if the Legislature were free to classify increases in value as "additions," it would undermine one of the intended purposes of Proposal A - to limit property taxes.

In striking down the occupancy addition, the court stated: *If what the amendment [Proposal A] had done was empower the Legislature, at its will, to define an increase in the value of property (such as an increase due to increased property) to be classified as an "addition," then the property tax limiting thrust of §3 would be, or could soon be if the Legislature desired it, thwarted. To adopt Troy's position regarding Legislative power to amend the meaning of terms understood at the time of ratification, would be to assume*

[1] See, [http://coa.courts.mi.gov/DOCUMENTS/OPINIONS/FINAL/SCT/20020514_S118750(78)_WPW.6Jan02.PDF].

the drafters and ratifiers of this amendment desired to place a convenient sabotaging clause within this tax limitation amendment that could be triggered whenever the Legislature chose. Such a skewed view of the intent, to say nothing of the capabilities, of the drafters and ratifiers, should be rejected. Moreover, to adopt such a mode of interpretation would, when applied in the future to other constitutional language, hollow the people's ability to place limits on legislative power. In short, to recognize such an expansive legislative power to redefine constitutional terms is inconsistent with the constitution's supremacy over statutes. Against this background, we see no principled way to determine the meaning of "additions" as used in §3 except by considering it as a term of art that must be construed in conformity with the meaning of "additions" as used in the General Property Tax Act at the time that Proposal A was adopted.[2]

Because the court did not address the issue of treating a decrease in occupancy rate as a "loss," the result is that under current law, a property's taxable value can be reduced because of a decrease in occupancy rate, but cannot increase when the occupancy rate subsequently increases. The Legislature and the Governor have attempted to "fix" the *WPW* decision numerous times since the 2003-2004 legislative session.

The first legislative attempt to "fix" the *WPW* decision came with the introduction of House Bill 6017 of the 2003-2004 legislative session. That bill, introduced by then-Representative John Pappageorge, would have simply eliminated the occupancy loss and addition provisions from the General Property Tax Act.

The administration first proposed "fixing" the *WPW* decision in 2005, as part of its proposed Michigan Jobs and Investment Act, its first attempt to revise the state's business tax code in light of the impending repeal of the Single Business Tax.[3] House Bill 4477 (introduced by then-Representative Andy Meisner) and SB 295 (introduced by Senator Gilda Jacobs), would have eliminated the "occupancy loss" and "occupancy additions" provisions for taxes levied after December 31, 2001 (i.e. before the *WPW* decision). Commercial rental property owners generally don't like the elimination of the occupancy loss provisions because, from their standpoint, the occupancy loss provisions are an attractive feature of the tax code since it lowers the taxable value to better reflect the property's true cash (market) value.

A second attempt at fixing the *WPW* decision in the 2005-06 legislative session was included as part of the ongoing negotiations between the Governor and the Legislature to restructure the state's tax system and find a suitable replacement for the Single Business Tax. (Thrown into the mix was a package of legislation securitizing the state's portion of

[2] In October 2006, the state Court of Appeals adopted the Supreme Court's *WPW* rationale in *Toll Northville, LTD and Biltmore Wineman, LLC v. Northville Township* (Docket No. 259021) and struck down a provision in the General Property Tax Act, MCL 211.34d(1)(b)(viii), that provided that the term "additions" also include the value of "public services" - i.e. water, sewer, primary access roads, natural gas service, electrical service, telephone service, sidewalks, and street lighting. That decision was upheld by the state Supreme Court in a decision issued on February 5, 2008 (Docket No. 132466).

[3] See House Bills 4476 and 4477 and Senate Bills 295 and 296 of the 2005-06 legislative session.

the tobacco settlement revenue.)[4] House Bills 5096 and 5097, introduced by then-Rep. Fulton Sheen, like the bills here, would have exempted commercial rental property from general ad valorem property taxes and subjected that property to a separate specific tax allowing for changes in taxable value attributable to both an occupancy loss and an occupancy addition.

Last session, the House took up HBs 4375, 4376, and 5286. (See also SBs 312 and 313, introduced by Sen. Gilda Jacobs). House Bills 4375 and 4376 were introduced by then-Representative Condino on March 1, 2007, and passed the House in April 2007. House Bill 5286 was identical to the House-passed version of HB 4376, which was later substituted in the Senate to permit Wayne County to collect, along with unpaid property taxes, any amount of the City of Detroit trash fee that was also unpaid. The substitute version was enacted as 2007 PA 31

A challenge to the occupancy loss provisions of the General Property Tax Act, *City of Southfield v. Cranbrook Centre LP and Americenter of Southfield,* 04-058112CZ, was filed on May 5, 2004 in Oakland County Circuit Court. The case was placed in abeyance on May 16, 2007, apparently waiting for a legislative solution to this issue.

Legislative Analyst: Mark Wolf
Fiscal Analyst: Jim Stansell

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.

[4] The tax bills were SB 633 and HBs 4342, 4972, 4973, 4980, 5095-5098, and 5106-5108. The securitization bills were SBs 298-359, 521, 533, and 664-667, and HBs 5047, 5048, 5109, 5215, and 5216. The Governor vetoed HB 5096 and HB 5107 and signed the other tax bills and all of the securitization bills. Because of an issue with the way the tax bills were tie-barred to each other, the Governor's veto of HB 5096 and HB 5107, allowed the remaining tax bills to become enacted into law, but did not allow them to take effect.