

Legislative Analysis



TAXATION OF COMMERCIAL RENTAL PROPERTY

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House Bill 4456 (Substitute H-1)

Sponsor: Rep. Vincent Gregory

Committee: Tax Policy

Complete to 6-16-09

A SUMMARY OF HOUSE BILL 4456 AS REPORTED FROM COMMITTEE 5-20-09

House Bill 4456 would amend the General Property Tax Act to eliminate the use of occupancy additions and occupancy losses in determining a property's taxable value.

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 or if the value of new construction had been reduced because of a below-market occupancy rate. In 2002, the state Supreme Court struck down the use of occupancy additions, meaning that a property's taxable value could be reduced because of a reduction in occupancy rate, but would not increase when the occupancy rate subsequently increased.

The bill limits the use of occupancy additions to prior to December 31, 2001, and limits the use of occupancy losses to prior to December 31, 2009.

MCL 211.34d

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:

House Bill 4456 attempts 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.

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 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.

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

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).

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 the tobacco settlement revenue.)⁴ House Bills 5096 and 5097, introduced by then-Rep. Fulton Sheen 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.

As introduced, House Bill 4456 would have exempted commercial rental property from general ad valorem property taxes under the General Property Tax Act. Commercial rental property would, instead, have been subjected to a "specific" property tax allowed for both occupancy additions and losses in determining taxable value under House Bill 4457.

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.

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■ 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.

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

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.