

# Legislative Analysis



## PRINCIPAL RESIDENCE EXEMPTION ON FORECLOSED PROPERTIES

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**House Bill 4135 (Substitute H-1)**  
**Sponsor: Rep. Frank Foster**  
**Committee: Tax Policy**

**Complete to 4-26-13**

### A REVISED SUMMARY OF HOUSE BILL 4135 AS REPORTED FROM COMMITTEE

Public Act 114 of 2012 amended the General Property Tax Act, generally speaking, so that a lender that becomes the owner of property that had been a principal residence as a result of a foreclosure or forfeiture can retain, under certain conditions, the principal residence property tax exemption on that property for up to three years. However, in this situation, although the lender keeps the exemption in place (for transfer to a future purchaser), the lender must pay the property taxes as if the exemption were not in place.

This means the lender must pay the equivalent of the 18-mills in local school operating property taxes, along with an administrative fee, as was the case prior to the passage of PA 114. The local unit retains the administrative fee, and the tax revenue is forwarded to the Department of Treasury for deposit into the State School Aid Fund. (Usually these 18 mills would remain with the home school district.)

(The language of these provisions is somewhat confusing because, as noted above, while the foreclosing entity "may retain an exemption" on the property, it is not in fact exempt from the property taxes but must pay amount that it "would have paid . . . if an exemption had not been retained.")

Under House Bill 4135, the lender/owner (or foreclosing entity) would no longer have to pay the equivalent of the local school operating taxes in these cases. The principal residence exemption would remain in place and the foreclosing entity would be exempt as if it were an owner occupying the home.

As noted, the set of provisions being amended were added to Section 7cc of the General Property Tax Act by Public Act 114 of 2012 (Senate Bill 349). That section deals with the principal residence exemption. The principal residence exemption is the exemption provided to owner-occupied homes; these taxpayers typically are exempt from the 18-mills of local school operating taxes but pay the 6-mill State Education Tax. Other taxpayers pay the full 24 mills.

Currently, as a result of the 2012 legislation, the lender/foreclosing entity can retain the principal residence exemption if all of the following conditions are met:

(1) the property is not occupied, other than by the person who claimed the exemption prior to the foreclosure or forfeiture; (2) the property is for sale; (3) the property is not leased to anyone other than the person who claimed the exemption prior to the foreclosure or forfeiture; and (4) the property is not used for any business or commercial purpose. The lender must file a "conditional rescission form" to retain the principal residence exemption and must annually verify that the four conditions still apply.

Under the H-1 substitute, condition (3) would be modified so that the property could not be leased to anyone (including the person who claimed the exemption prior to the foreclosure or forfeiture) for the principal residence exemption to be retained.

## **FISCAL IMPACT:**

The fiscal impact of the bill can vary greatly depending on the number of bank-owned foreclosure properties and the taxable values of those properties. Based on February 2014 data of foreclosures in Michigan from RealtyTrac, the bill as reported from committee could potentially reduce School Aid Fund revenue from the 18-mill levy by \$25 million to \$30 million on an annual basis. If the number of foreclosures continues to decline (the percentage of bank-owned foreclosures in Michigan has dropped from 62.3% to 40.2% of total foreclosures over the past year), the annual revenue reduction could fall as well.

## **BACKGROUND AND DISCUSSION:**

Generally speaking, owner-occupied homes are exempt from local school operating taxes. This exemption is known as the principal residence exemption, and typically a homeowner is only entitled to one such exemption. To claim the exemption, an owner must file an affidavit with the local tax collecting unit where the property is located. Properties with this exemption are exempt from the 18 mills of local school taxes and pay only the 6-mill state education property tax. Properties without this exemption pay the full 24 mills of local and state school operating taxes.

In 2012 the General Property Tax Act was amended so that a foreclosing lender (a bank or credit union, for example) could maintain the principal residence exemption on a home being foreclosed on. Generally speaking, the aim of this amendment was to make it easier administratively to pass on the exemption to new purchasers without interruption or complications. This was seen as a boon to financial institutions and real estate professionals engaged in the resale of these foreclosed properties at a time when there are an enormous number of foreclosed-upon homes.

At the same time, even though the "exemption" technically remained with the property so that it could be passed on seamlessly to a new buyer, the lender was required to pay the taxes that the "exemption" would otherwise have exempted the property from. The only difference was that the taxes paid by the lender would go directly to the state School Aid Fund rather than to the local school district. In order to keep the exemption running with the home certain conditions must be met; these include that the property be for sale, not be occupied (except by the previous owner), and not be leased (except to the previous

owner). The forms that a foreclosing lender must use can be found on the Department of Treasury site at: [http://www.michigan.gov/taxes/0,4676,7-238-43535\\_43539---,00.html](http://www.michigan.gov/taxes/0,4676,7-238-43535_43539---,00.html). These include a "conditional rescission" form to retain the exemption and the "foreclosure entity payment form" that is used to pay the taxes.

Prior to this amendment, presumably, the lender not only paid the local school taxes but the home lost the principal residence exemption and the new buyer then had the burden of obtaining the exemption and, depending on the timing, might not get the full benefit of the exemption in the first year of home ownership.

The 2012 amendment was part of a larger proposal that changed the filing deadline for claiming a principal residence exemption. Instead of the May 1 filing deadline, under the new act the filing deadline is June 1 for the next summer tax levy and November 1 for the winter tax levy.

House Bill 4135 would eliminate the requirement that the foreclosing lender pay the equivalent of the 18-mill local school operating property tax. The argument for this is that since banks now have to pay the tax anyway, the paperwork involved in keeping the exemption attached to a home is not worth the trouble. As a result, lenders are not motivated to participate. This means the original problem for new homebuyers remains: they themselves must seek a homestead exemption and may not be able to get the full benefit of the exemption in the first year of home ownership.

The aim of the proponents of the bill is that foreclosed homes be sold more quickly. That goal is considered desirable enough to justify the policy (and the cost) of keeping a house fully exempt as a principal residence while in the hands of the foreclosing entity. Lending institutions point out that reducing the taxes they owe on a home reduces their expenses and allows them to lower the list price of the home.

The opposition to the bill from the Department of Treasury and the public school community is based primarily on the high cost to the State School Aid Fund of such an approach. The bill would eliminate the property tax revenue that foreclosing entities would otherwise have to pay the SAF for the support of schools without identifying any replacement revenue. They also note this undoes compromise legislation enacted only last session.

## **POSITIONS:**

The following organizations indicated support for the bill during committee deliberations: The Michigan Credit Union League, the Michigan Association of Bankers, and the Michigan Association of Realtors. (3-13-13, 3-20-13 & 4-10-13)

The Department of Treasury is opposed to the bill. (4-10-13)

The following were among those indicating opposition to the bills: the Michigan Association of School Boards, the Michigan Association of School Administrators, Michigan Elementary and Middle School Principals, Michigan Secondary School

Principals, the School Equity Caucus, the Middle Cities Education Association, and the Michigan Association of Intermediate School Districts. (3-13-13 & 3-20-13)

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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.