

Legislative Analysis



COMMERCIAL RENTAL PROPERTY TAX

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House Bills 4375 and 4376 as introduced

Sponsor: Rep. Paul Condino

Committee: Tax Policy

First Analysis (4-15-07)

BRIEF SUMMARY: 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 property. House Bill 4375 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. House Bill 4376 would exempt commercial rental property that is subject to the new specific tax from general ad valorem property taxes.

FISCAL IMPACT: These bills would increase School Aid Fund (SAF) sources by an estimated \$5 million (\$1.25 million increase in State education tax revenue and a decrease in expenditures of \$3.75 million). In addition, property tax revenue for local units of government would increase by an estimated \$5.8 million.

THE APPARENT PROBLEM:

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 *WPW Acquisition v. City of Troy* (466 Mich 117), the state 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. At the time Proposal A was approved by the 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.¹ Because the court did not address the

¹ 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

issue of the 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.²

To correct the problem created by the *WPW* decision, legislation has been introduced to remove commercial rental property from general ad valorem property taxes and impose a separate, specific tax that considers both additions and losses attributable to a change in occupancy rate when determining the property's taxable value.

THE CONTENT OF THE BILL:

Together, the bills would put in place a new method of taxing commercial rental property by exempting such property from general ad valorem property taxes under the General Property Tax Act, and levying a new specific on that property instead.

House Bill 4375

Under House Bill 4375, 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 previous years, 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 2008, 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 2008 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 May 14, 2002 and before the bill's effective date, notwithstanding the state Supreme Court's *WPW* decision.

Beginning in 2008, 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 of the square footage of occupancy as of the immediately preceding December 31st. After 2008, 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.

General Property Tax Act, MCL 211.34d(1)(b)(viii), that provided that the term "additions" also included the value of "public services"— i.e. water, sewer, primary access road, natural gas service, electrical service, telephone service, sidewalks, and street lighting. That decision is on appeal to the Michigan Supreme Court.

² A challenge to the occupancy loss provisions of the General Property Tax Act involving the City of Southfield is currently pending before the Oakland County Circuit Court.

The tax rate would be the number of mills assessed in the local tax collecting unit as if that 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.

House Bill 4376

The bill would exempt commercial rental property from the General Property Tax Act if the owner previously claimed an occupancy loss 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 new property is constructed; 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 from when property is no longer considered commercial rental property. Failure to file a rescission would be a penalty of \$5 a day, up to \$200, for each day after the 90-day period. The penalty would be deposited in the School Aid Fund.

Assessors could deny an exemption claim for the current year and the preceding three years. If an exemption is denied, the tax roll would be amended to reflect the denial and a corrected 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.

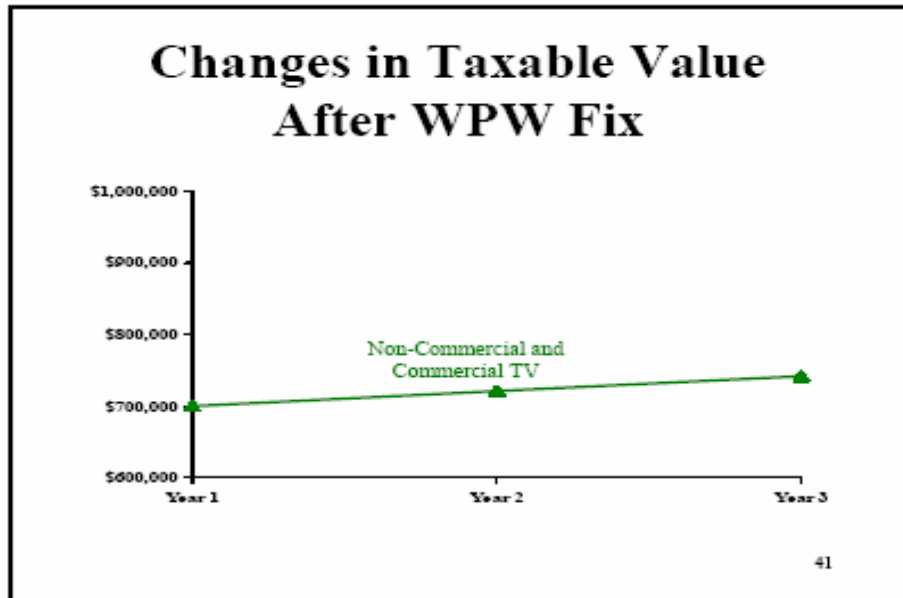
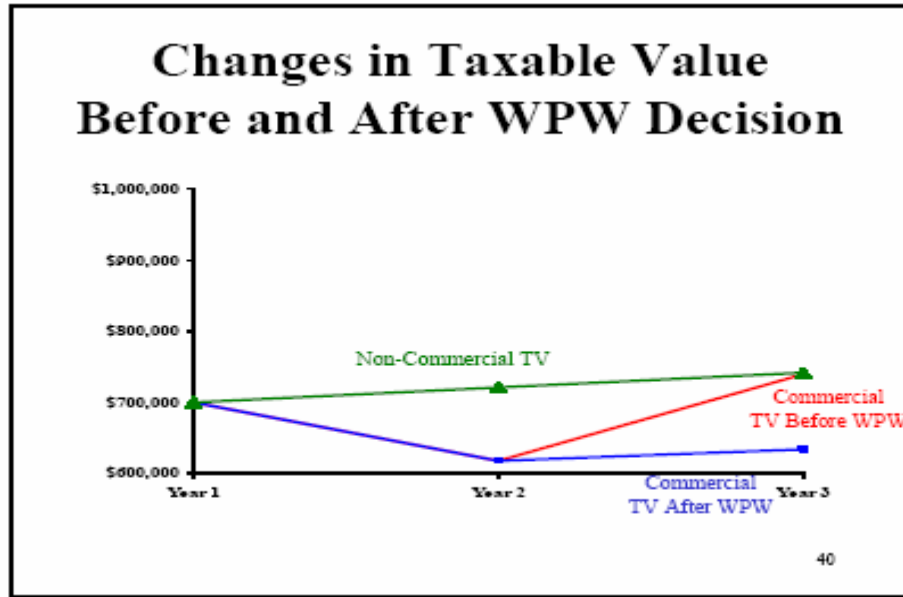
In addition, the bill would amend current law concerning occupancy losses and additions (MCL 211.34d) to specify that an occupancy loss may be taken prior to May 14, 2002 (the date of the WPW decision) and that an occupancy addition may be taken prior to December 31, 2007.

BACKGROUND INFORMATION:

The bills are part of the tax restructuring proposal that accompanied Governor Granholm's FY 2008 Executive Budget Recommendation. Other components of that proposal include a replacement for the Single Business Tax, a 2% excise tax on services, allowing for a trade-in allowance for the sales tax paid on new motor vehicles, increasing the tax on cigarettes and other tobacco products, increasing the liquor markup,

decoupling the estate tax from the federal estate tax, increasing penalties for failing to pay a tax or file a return, and eliminating a number of corporate tax "loopholes."

In testimony before the House Committee on Tax Policy, the Department of Treasury provided by the following graphs illustrating the effect of the *WPW* decision on taxable value resulting from increases and decreases in occupancy rate and affect of the bill.



WPW Acquisition v. City of Troy

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 occupancy) 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 out 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.*

Prior Legislation

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 (and current state Senator) 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. (See House Bills 4476 and 4477 and Senate Bills 295 and 296 of the 2005-06 legislative session.)³ House Bill 4477, introduced by Rep. Andy Meisner, and Senate Bill 295, introduced by Sen. Gilda Jacobs, would have eliminated the "occupancy loss" and "occupancy addition provisions" for taxes levied after December 31, 2001 (i.e. before the WPW decision). Commercial rental property owners generally don't like the eliminating the occupancy loss provisions because, from their standpoint, the occupancy loss provision is an attractive feature of the tax code because 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 prior 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.

³ At the time, Enacting Section 1 of 2002 PA 532 repealed the Single Business Tax Act at the end of 2009. House Bill 4476 would have repealed this enacting section and extended the SBT Act. Subsequent to that, the legislature enacted, without the governor's signature, 2006 PA 325, an initiated law repealing the SBT Act at the end of 2007.

(Thrown into the mix was a package of legislation securitizing the state's portion of tobacco settlement revenue.)⁴ House Bills 5096 and 5097, introduced by Rep. Fulton Sheen, like the two bills this session, 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.

House Bill 4375 is identical to the Senate-passed version of House Bill 5096 of last session. (See Senate substitute S-2.) The enrolled version of the bill, substitute H-5, which was ultimately vetoed by the governor, was prospective in scope, while last year's Senate substitute was retroactive, as is House Bill 4375. That is to say, the enrolled bill used as its starting taxable value, the value as determined within the limits of *WPW* (occupancy losses without occupancy additions). This effectively provided a permanent tax cut for that property until ownership of that property was later transferred because the property must first take an occupancy loss before there is an occupancy addition. The current bill and last year's Senate-passed substitute, by contrast, use as their starting taxable value, the value the property would otherwise have were it subject to the General Property Tax Act, plus any occupancy addition since the *WPW* decision. This, in a sense, operates as if the *WPW* decision never occurred.

ARGUMENTS:

For:

As a result of the *WPW* decision the taxable value of commercial rental property can be adjusted downward to reflect a decrease in occupancy rate, but cannot be readjusted upward, above the assessment cap, when the occupancy rate later increases. The *WPW* decision throws off the delicate balance between what were intended to be offsetting provisions allowing for occupancy losses and additions. Although the court struck down the occupancy addition, it did not address the occupancy loss provision. Fairness in the tax code mandates a return to the system in place prior to the *WPW* decision, by allowing for both an occupancy loss and a corresponding occupancy addition.

Against:

The bills set a dangerous precedent by the legislature to get around the limits of Proposal A and the state constitution by creating a specific tax that is, in all other respects, a general ad valorem property tax. If the legislature can enact a tax on commercial rental property that is outside the bounds of the constitutional limit on assessments, what prevents it from enacting similar changes on, for instance, residential property?

Against:

Critics argue that the bills should not allow the retroactive capture of occupancy additions that should have been taken, but weren't, as a result of the *WPW* decision. This unfairly

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.

burdens property owners who have followed the law in good faith and could face large tax increases as the taxable value is readjusted upward.

POSITIONS:

The Department of Treasury supports the bills. (3-27-07)

The Michigan Municipal League supports the bills. (3-27-07)

The Michigan Townships Association supports the bills. (3-27-07)

The Michigan Association of Counties supports the bills. (3-27-07)

The City of Southfield supports the bills. (3-27-07)

The City of Grand Rapids supports the bills. (3-27-07)

The Michigan Education Association supports the bills. (3-27-07)

The Michigan Association of School Boards supports the bills. (3-27-07)

The American Federation of Teachers – Michigan supports the bills. (3-27-07)

The Michigan Small and Rural Schools Association supports the bills. (3-27-07)

The Oakland Schools supports the bills. (3-27-07)

The Ottawa Area Intermediate School District supports the bills. (3-27-07)

The Muskegon Area Intermediate School District supports the bills. (3-27-07)

The Kalamazoo Regional Educational Service Agency supports the bills. (3-27-07)

The Michigan Chamber of Commerce opposes the bills. (3-27-07)

The Michigan Association of Homebuilders opposes the bills. (3-27-07)

The Building Owners and Managers Association opposes the bills. (3-27-07)

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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.