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BILL



ANALYSIS

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Senate Bill 907 (Substitute S-1 as passed by the Senate)
Sponsor: Senator Jack Brandenburg
Committee: Finance

Date Completed: 6-20-12

RATIONALE

Some people believe that the beneficiary of a trust, who is living in a home owned by the trust, should be eligible to claim the principal residence exemption under the General Property Tax Act. The Act allows the owner of a home to claim an exemption from taxes levied by a local school district for school operating purposes, which are typically 18 mills. To qualify for the exemption, the taxpayer must use the property as his or her principal residence and, as a rule, he or she cannot claim the exemption on more than one property. The Act contains a definition of "owner" for purposes of this exemption; among others, the term includes a person who owns property as a result of being a beneficiary of a trust, and a grantor who has placed the property in a revocable trust or a qualified personal residence trust. The definition also includes the sole present beneficiary of a trust if the trust acquired the property as a principal residence for that person and he or she is totally and permanently disabled. In addition, according to Department of Treasury guidelines, the beneficiary of a trust is eligible for the exemption upon the death of the grantor, if the beneficiary is living in the home.

Despite these provisions, the Department and local assessors evidently are denying the principal residence exemption in situations in which the trust continues to own the property after the grantor dies, as well as situations in which the beneficiary lives in the home while the grantor is still alive. It has been suggested that the principal residence exemption should be allowed under these circumstances, if all other criteria are met, because the

beneficiary would be eligible for the exemption if the property were in his or her name.

CONTENT

The bill would amend the General Property Tax Act to include in the definition of "owner", for purposes of the principal residence exemption, a present beneficiary of a trust if the trust owns the property and it is the principal residence of the present beneficiary.

Before claiming the principal residence exemption, the present beneficiary would have to file an affidavit with the local assessor, notifying him or her that the present beneficiary was claiming an exemption for property owned by the trust. The affidavit would have to include the beneficiary's name, the address of the property, and a statement that the beneficiary had met all requirements for a principal residence exemption.

MCL 211.7dd

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

There are numerous reasons that people create a trust and transfer property to it for a beneficiary, or set up a trust that will acquire property for a beneficiary. In some situations, a husband and wife own property separately for tax purposes and the spouse owning the home puts it in trust to ensure that the surviving spouse can continue to

live there after the owner dies. In other cases, the parents of a spendthrift child will put a house in trust, or a trust will be instructed to buy property for the child, so he or she will have a place to live and not be able to squander it. Another situation involves a husband and wife who own property from previous marriages and set up trusts to ensure that the property goes to the offspring from those previous marriages. In these and many other scenarios, the trust might own a home that the beneficiary is using as his or her principal residence; sometimes, the grantor has died and the trust continues to own the property, and in other situations the grantor is still alive.

In any case, if the beneficiary of a trust-owned home is occupying the property as his or her principal residence, and otherwise meets the criteria for an exemption from school operating taxes, it is not reasonable or logical to deny the exemption simply because the property is not in the name of the individual beneficiary. The statute already allows the exemption to be claimed by a grantor who uses continues to live in property transferred to a trust, by a disabled beneficiary of trust-owned property, and by a person who owns only a fraction of a home. The Department of Treasury's guidelines also state that the beneficiary of a trust is eligible for the exemption when the grantor dies; since the beneficiary becomes the owner if the trust terminates, it is reasonable to read the guidelines as applying to situations in which the trust continues. In addition, the Act extends the exemption to a person who owns property as a result of being a beneficiary of a trust; once the person inherits the property, however, he or she becomes the owner. Unless this refers to the present beneficiary of a trust, the language is superfluous.

Although a beneficiary can appeal a denial to the Tax Tribunal, some people find the process too time-consuming and frustrating, and simply pay taxes at the higher rate. An appeal reportedly can take two or three years and, if the denial is upheld, the taxpayer will be liable for several years of school operating taxes plus interest and penalties. This is unfair to individuals who are ineligible for the exemption for no reason except that their home is held by a trust.

Opposing Argument

The bill is too broad. Potentially, one wealthy person or family could set up multiple trusts that each would own a home for a beneficiary, or one trust that would own multiple homes for different beneficiaries. In either case, that person or family would benefit from multiple principal residence exemptions. This raises an issue of fairness. The statute specifically limits the exemption to one per taxpayer, and nonwealthy taxpayers must abide by that limit. In addition, the bill would be too costly to the School Aid Fund, which would have to make up the revenue lost by schools. The broader the exemption, the greater the cost would be.

A narrower approach would be to allow the present beneficiary of a trust to claim the exemption only if he or she were the spouse or child of the grantor, or allow only one present beneficiary of a trust or grantor to claim the exemption.

Response: The number of beneficiaries per trust or the number of trusts created by a single grantor should not make any difference. As it is written, the bill would allow only one taxpayer to claim the exemption for only one principal residence, as the law allows for any other homeowner.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would increase State School Aid Fund expenditures by an unknown amount. Property that qualified for the exemption as a result of the bill would no longer be obligated to pay locally levied mills for school operating purposes. (For most school districts this represents a levy of 18 mills.) Any revenue loss to the local unit would be offset by increased School Aid Fund expenditures in order to maintain per-pupil funding amounts. The actual impact would depend on the number of properties affected by the bill, as well as the specific characteristics of each property.

No data exist on the number of properties or trusts that would be affected by the bill, but in 2010 more than 64,600 Michigan trusts were required to file returns with the Internal Revenue Service. If 5% of these trusts were affected by the bill, and the average taxable value of each affected property were \$100,000, exempting affected

properties from the 18-mill levy would increase School Aid Fund expenditures by approximately \$6.0 million per year.

The bill also would reduce State income tax revenue to the General Fund by an unknown and likely minimal amount, by increasing the number of properties that could potentially qualify for a homestead property tax credit.

Fiscal Analyst: David Zin

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.