Senate Fiscal Agency
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BILL ANALYSIS

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Senate Bill 425 (Substitute S-1 as reported from Committee) *(as passed by the Senate)*
Sponsor: Senator Jack Brandenburg
Committee: Finance

Date Completed: 11-1-13

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 defines "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 have been 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 eligible for the exemption if the property were in his or her name.

CONTENT

The bill would amend the General Property Tax Act to allow the present beneficiary of a trust to claim a principal residence exemption for property owned by the trust, if it were the beneficiary's principal residence.

Specifically, the bill would include in the definition of "owner", for purposes of the principal residence exemption, a present beneficiary of a trust if both of the following conditions were met:

-- The property was the principal residence of the present beneficiary.
-- The present beneficiary, before claiming an exemption, filed an affidavit with the assessor of the local tax collecting unit notifying the assessor that the beneficiary was claiming a principal residence exemption for property owned by the trust.

The affidavit would have to be in a form prescribed by the Department of Treasury, and 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 son or daughter will put a house in trust, or a trust will be instructed to buy property for the individual, 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. A Department of Treasury guideline also states 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 apply the guideline 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.

The principal residence exemption has been in place for nearly 20 years. According to testimony before the Senate Finance Committee, the present beneficiary of a trust was allowed to claim the principal residence exemption during most of that time period. In the last couple of years, however, the Department started to audit trusts and deny the exemption.

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 would reduce local property tax revenue for public school districts. Although the potential impact of this proposal by itself might not be significant, the bill is one of many that would erode local revenue and the School Aid Fund. When combined, these measures could add up to a serious revenue loss over time.

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