REAL PROPERTY TAXES IN MICHIGAN
November, 2016

One of the most significant expenses of owning and maintaining vacation property is property taxes. Michigan has a somewhat complex and often confusing system of assessing taxes. The following information will explain how property taxes are computed on Michigan property.

In most states, including Michigan, each parcel of real estate is taxed based on its “value.” In 1994, Michigan voters passed a constitutional amendment limiting how much property value could appreciate each year for property tax purposes. This limit is 5% or the rate of inflation, whichever is less. At the same time, property appreciates in market value at a rate that is not limited except by market forces. This has resulted in each parcel having two different values—one for property tax calculations, and one for market purposes. The value for property tax purposes is sometimes called the “capped” value and is shown on your tax bill as the “Taxable Value” (sometimes abbreviated as “TV”). The value for market purposes is designated on the tax bill as the “State Equalized Value” (sometimes abbreviated as “SEV”). Taxable Value is a totally artificial value and is used for no purpose other than calculating the amount of property tax assessed on your parcel. Both values will be shown on the annual assessment that is sent out by your Township on or before March 1 of each year, and will also be shown on the two tax bills you receive each year.

The SEV is, by law, 50% of the fair market value as determined by the Township tax assessor. This means that if the SEV is shown on your assessment as $100,000, the assessor in your Township has determined that the market value of the property is $200,000. Since State Equalized Value is 50% of fair market value, to calculate fair market value, one must multiply SEV by 2. There is no logic to this—it is simply the way the values are calculated.

In an appreciating market where property values are increasing at a rate greater than the rate of inflation, SEV grows at a rate much faster than Taxable Value. The result is that in many cases involving vacation property, it is not unusual for SEV to be 3, 4 or 5 times larger than the Taxable Value. So long as ownership of the property remains the same, SEV has little, if any, impact on the owner.

This split in values continues until there is a “transfer of ownership” of the property. The definition of “transfer of ownership” is a very technical definition, and depends entirely on a number of factors related to the property. If the owner is an individual, or a group of individuals, the basic rule, before any exceptions, is that there is a transfer of ownership whenever there is a change in title, or any portion of the title, to the property from one individual to another one. When there is a transfer of ownership, the value on which property taxes are based is “uncapped” and goes from the Taxable Value of the prior owner to the State Equalized Value of the prior owner. To take the easiest example, if you own 100% of property with a Taxable Value of $10,000 and a SEV of $40,000, your property taxes are based on the $10,000 figure. When you sell the property to another person, the new owner’s Taxable Value goes up to $40,000, and that is the figure on which the new owner’s taxes are calculated.

If property is owned by more than one individual, and only one co-owner transfers his/her fractional interest, then the new tax base is split between the non-transferring co-owner and the new co-owner. If property is owned as tenants in common (i.e., no rights of survivorship), and one co-owner transfers his
ownership interest, then the new tax base would be a combination of the old “Taxable Value” and the SEV. For example, in mathematical terms using the above figures, the tax base after a transfer of an undivided one-half (½) interest would be $25,000. The capped value is $10,000 and the uncapped value is $40,000, a difference of $30,000. One-half of the property was transferred, so one-half of the difference is added to the old tax base, and the new tax base is $25,000 ($10,000 + $15,000 = $25,000). If both owners transfer their respective one-half interest, the new tax base for the new owner would be $40,000. This is the easy case.

Things get more complicated when property is owned by a trust. The State of Michigan has stated that when property is owned by a trust, a “transfer of ownership” occurs when there is a change in the present beneficiaries of the trust, even though title to the property remains in the trust. So, if John and Mary create a trust for estate planning purposes, transfer their cottage into the trust, that trust is the new owner. However, there is no uncapping at that point if John and/or Mary are the present beneficiaries of that trust. When John and Mary die or voluntarily give up their interest in the property, there is a “change of beneficiaries” of the trust which constitutes a “transfer of ownership” even though title to the property has not changed at all. Many people are under the mistaken belief that because title to the property hasn’t changed, there is no transfer of ownership and taxes remain the same. Unfortunately, this is simply not true—the change of beneficiaries results in a change in the value on which property taxes are based, and in the typical case, taxes will go up. However, see changes in the law below.

The uncapping rules for property owned by an LLC are very different. The law allows an owner to transfer ownership of property to an LLC without “uncapping” or increasing the tax base so long as the LLC is owned by the same people in the same proportions as the property was owned before the LLC was created. The Taxable Value will not change until MORE THAN fifty percent (50%) of the ownership of the LLC is transferred to new owners. This 50% is counted on a cumulative basis from the date the LLC receives ownership of the property. The owners of the LLC must continue to keep track of all ownership transfers, and when more than 50% of the ownership has been transferred, the “cap” is entirely removed and the new Taxable Value will be the same as the SEV for the property. A new cap is then put into place, and the counting of ownership transfers starts all over again.

BUT, as a result of changes in the law in 2013, 2014 and 2015, there is some relief from these typical “transfer of ownership” rules described above. Transfers of property to a spouse, parent, sibling, child (including adopted child or children) or grandchild are exempt transfers and do not count as “transfers of ownership” for property tax purposes. Similarly, if the new present beneficiary of a trust is one of those relatives of the person who created the trust, then there is no uncapping. Also, if the new owner takes title to property at the end of a life estate of one those relatives, there is no uncapping.

Please note that the class of exempt relatives includes those relatives of the spouse of the property owner, so many in-laws of the property owner may also be exempt from uncapping. However, all of the exemptions from uncapping on transfers to close relatives will be lost if the property is used for any commercial purpose after the transfer. This “commercial purpose” includes renting the property for more than fifteen (15) days in any calendar year.

Unfortunately, the exemptions for transfers to close relatives do NOT apply to transfers of ownership of an LLC that owns property. We are working to add these transfers to the list of exempt transfers, but at the present time, the uncapping rules for LLCs described above apply regardless of the relationship of the new LLC owner.

As you can see, the issue of property taxes becomes somewhat confusing and complicated. If you have any questions regarding your property taxes, please contact David Fry at the Cottage Law Center.