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Michigan Property Tax Prorations

By Joseph M Turner

AN ARTICLE FOR THE MICHIGAN
ASSESSOR'S ASSOCIATION

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Michigan Property Tax Prorations Tax Proration Guidelines and Practices

If you want to have a fun argument, begin a discussion on prorating property taxes. I guarantee, you'll eventually be swamped by a number of opinions, each being promoted passionately as "the" true way to prorate taxes.

In part, this is because Michigan law is very flexible on how taxes may be prorated. Oh, by the way proration means: "To make an arrangement on a basis of proportional distribution. To divide or distribute proportionately." (The American College Dictionary, Page 972, 1960)

Buyers and Sellers can agree to prorate taxes in any way they'd like. There are also common ways to prorate real estate taxes which vary depending upon local custom. By examining practices throughout the state, you'll discover taxes are commonly prorated as though paid in "advance". You may also discover, they are commonly prorated as "paid in arrears" and they are commonly prorated as: part in advance and part in arrears. In some cases buyers and sellers even agree to no tax proration.

During my tenure in an assessor's office, we were called on from time-to-time to settle tax proration disputes. So, the material which follows consists of information callers would receive if they inquired about methods of prorating property taxes in Michigan.

1. A buyer and seller may agree (create a contract) to prorate property taxes in any way they'd like; if such an agreement exists it should be followed.

2. Michigan's Property Tax Act, (Act 206, 1893; M.C.L. 211.2 et seq) provides specific instructions on how to prorate property taxes at a closing when no proration agreement exists between the buyer and seller. A quote from the act follows later, but basically, taxes are prorated as though paid in advance with the seller being responsible for all tax levies made prior to, but not including, the date of closing. The buyer must pay all future tax levies (and any taxes that might actually be levied on the date of closing). If a levy occurs pursuant to the statute, there is an assumption that a proration must occur for any taxes levied within the twelve months preceding the closing date. Property taxes are to be considered as being levied for a twelve-month period

beginning with the levy date. Prorations must be made under this section for two time periods in each levy: 1) A time period during which the seller had possession, which runs from the levy date to and including the day before closing; and 2) a time period during which the buyer has possession, which runs from the date of closing through and including the last day of the twelve months period following the levy date. The buyer is not responsible for any part of the real estate tax between the levy date and the date of the real estate transaction "closing". The buyer is responsible for that part of each tax from the closing date to and including the last day of the twelve-month tax period. This effectively is a proration of taxes in advance.

I am aware of a fellow who was truly quite intelligent, but who suffered from overconfidence in matters of property tax prorations. Many years ago, he made his first One Million Dollar purchase (some commercial real estate). The transaction took place in a county where the customary practice was to prorate taxes as though paid in arrears. The purchase agreement did not address the issue of tax prorations. This fellow assumed that the proration would be in arrears, which as you will see later, created a financial advantage to him. Unfortunately, the seller had competent counsel in matters of taxation. So at the closing, the portion of Michigan's law which deals with proration of real estate taxes in purchases between private parties was pointed out. The quite intelligent fellow immediately was enrolled in the school of hard knocks and coughed up \$15,000 in cash to pay for his tuition. That is, instead of collecting money from a property tax proration at closing, he paid money for the proration of taxes. The difference between what he would have received and the amount he ended up paying was \$15,000. An expensive lesson even today.

3. The term "levy date" means the date a tax becomes due and payable. This is an important point, because in Michigan a "winter" tax becomes due and payable on December 1st of each year, but it may be paid without any penalty or interest charged as late as February the 14th following the levy date of December 1st. A similar, but shorter, time period is used for summer tax levies. So, there is a date the bill becomes due and payable (levy date) and a date late fees and interest start. For tax proration purposes, you must use the levy date.

4. The terms "paid in advance" or "paid in arrears" refer to the relationship between the time a tax is levied and the time period in which the money is used. Simply put, to "pay in advance" means taxpayers pay a tax and the collection of money is used in the future (usually over one year). To "pay in arrears" means you get billed taxes for services a government unit has already provided.

5. An argument for taxes paid in arrears is an argument which states that a property owner holds real estate or personal property for a time period and then a tax is levied to pay for public services available to the property owner during that time period. For example, an argument in arrears conveys the idea fire protection was available during the past year and a tax is levied now to pay for that past service. Thus, a property tax is levied today (or in the future), to pay for services rendered last year.

6. An argument for taxes paid in advance is an argument which states that a property owner must pay now to receive a future service. That is, a property owner first pays taxes then receives the service. In the example above, a tax would have been levied first, so future funding was in place to finance fire protection.

7. You may usually determine how your taxes are levied and whether they are paid in advance or in arrears from printed statements on your tax bill. For example, on the typical "winter" tax bill, you will find a due and payable date of December 1st. The fiscal year in which the money collected is to be used almost always begins on January 1 following due and payable date (levy date). Money begins to be collected on December 1st and the fiscal year to which those funds are applied begins on the January 1st immediately following the due date. This is a payment in advance.

Examine your "Summer" tax bill. Most jurisdictions have a due date of July 1st (levy date) and the fiscal year printed on the bill for which the collected funds are to be used. This fiscal year is usually from the due date of the summer tax bill (July 1st) through and including June 30th on the next calendar year.

Thus, the fiscal year for which winter tax bills apply often correspond to the calendar year (January 1st through December 31st) - the fiscal year immediately following the levy date. Winter taxes are often prorated based upon the fiscal year associated with a levy. However, it is also not uncommon to see winter taxes (the Dec. 1st levy date) being prorated for a twelve-month period beginning December 1st (the levy date), instead of a proration based upon a January through December calendar (and fiscal) year. The fiscal year in which collections from summer tax bills will be prorated is usually July 1st through June 30th - a twelve-month period running from the levy date of the summer bill.

As a minor point, it may be worth noting that the "fiscal year" (budget year) of local units of government usually vary from the fiscal year of the state of Michigan or Federal Government. Both the State and Federal government have implemented fiscal years which run from October 1st through September 30th.

There are exceptions. For example, some small units of government (e.g. a village) may have a fiscal year which varies from the common January and July fiscal years. We can use this third fiscal year to illustrate tax proration from a new perspective. First, let us assume a small unit of government has its taxes collected by a larger unit of government which levied in July and December. Let us also assume the small unit of government has a fiscal year which is different than the two fiscal years just mentioned (I have seen a unit of government use an April through March fiscal year). Taxes collected

in July for the unit of government with an April through March fiscal year would be an example of a mixed tax levy with regard to prorations.

That portion of the July tax bill applied to the April beginning date for the fiscal year and the July due date would truly be levied in arrears. That portion of the July tax bill used by this village from July 1st to March would be paid in advance.

8. Within Michigan, tax proration agreements have evolved based upon customary practices within specific geographic areas. It is "customary" to prorate taxes in historically rural areas as though the taxes are paid in arrears. It is customary to prorate taxes in historically cosmopolitan and urban areas as though the taxes are paid in advance. In the middle of the lower peninsula, there is a transitional area where the I-75 industrial corridor meets the recreational lands. In this area of the state, you will find it customary to prorate summer tax levies as though paid in advance and winter taxes (on the same property) prorated as though paid in arrears. Tax proration in the city of Saginaw are one example of this blending of tax proration methods.

9. When taxes are prorated as though paid in arrears, the financial advantage is given to the buyer. It works in this way. At closing, a proration in arrears assumes that any future tax bill to which a proration would apply (say, all levies in calendar year 2006) are for the twelve-month time period immediately preceding the levy date. Thus, services provided by government during that time period benefitted the seller during the time period in which he or she owned the property. Therefore, at closing, the seller must pay the buyer money in an amount equal to the taxes levied for services provided during the seller's ownership. So, the argument is, with a proration in arrears, at closing the seller reimburses the buyer for taxes levied that apply directly to the time period during which the seller owned the property.

10. When taxes are prorated as though paid in advance, the financial burden for paying taxes levied within the preceding twelve months shifts to the buyer. The assumption is, the seller paid taxes in advance for a full year's worth of services. However, at closing, the seller will no longer be benefitting from those services - the buyer will - and therefore the buyer must reimburse the seller for taxes previously paid but not used. Simply put, the seller paid for twelve months service and deserves to be reimbursed for that portion of the twelve months during which the buyer will have possession of the property.

11. In cases where some of the taxes are prorated as though paid in advance and some of the taxes are prorated as paid in arrears, the two principles are separated and used only on the specific tax levy to which they apply.

Here is the quotation from Michigan Compiled Laws section 211.2(4). This kicks in if there is no proration agreement in a sale between private parties. A similar provision exists for sales involving government transactions.

"In a real estate transaction between private parties in the absence of an agreement to the contrary, the seller is responsible for that portion of the annual taxes levied during the 12 months preceding, but not including, the

day title passes, from the levy date or dates to, but not including, the day title passes and the buyer is responsible for the remainder of the annual taxes. As used in this subsection, "levy date" means the day on which a general property tax becomes due and payable."

The Table which follows illustrates tax prorations based upon a levy being prorated on a monthly basis with there being 30 days per month. Thus, in this illustration, the "summer" tax bill where the tax levy is \$1200, each month of possession equates to \$100 and each day equates to \$3.33. In the "winter" illustration, the amount taxed is the same (\$1,200) but the time periods vary.

Note that the fiscal year for the "summer" tax runs from July 1st through and including June 30th following. The fiscal year for the "winter" tax bill runs from the period January 1st through December 31st which

follows the levy date. All prorations illustrated are based upon a proration for the fiscal year. As explained above, buyers and sellers may select another method of their choosing.

As an alternative, one might choose to use the exact number of days in the month of proration; others might prefer to prorate by basing the calculations on the exact number of days which have passed between the levy date and the date of closing. The buyer will have to escrow taxes for future payments in addition to whatever is paid or received from a proration.

Please note that using 30 day months for the calculation of tax prorations resulted in variances of between ten cents and five cents from the annual tax of \$1,200 in these examples. Using a daily method of proration will produce greater accuracy.

EXAMPLE - PRORATING A SUMMER TAX IN ADVANCE OR ARREARS (July 1 st - June 30 th)						
Taxes In Advance	July 1 st Levy	November 15 th Close	Seller's Possession was 4 mos 14 days (July - Nov.) (Seller paid for one year and is reimbursed)		Buyer's Possession will be 16 days 7 months (Nov. - June)	
\$1200	Seller		\$0	\$753.33	\$753.33	\$0
Levied Amount	Paid in Advance		At Closing Seller Pays	At Closing Seller Receives	At Closing Buyer Pays	At Closing Buyer Receives
Taxes In Arrears	July 1 st	November 15 th	Seller's Possession was 4 months 14 days (July - Nov.) (Assumes tax not yet levied)		Buyer's Possession will be 16 days 7 months (Nov. - June)	
\$1200			\$446.62	\$0	\$0	\$446.62
Estimated Levy	Buyer will pay		At Closing Seller Pays	At Closing Seller Receives	At Closing Buyer Pays	At Closing Buyer Receives
Note: Buyer may also be required to "escrow" enough money to cover the upcoming tax bill in full. Note: Difference in proration for Seller: Receives \$753.33 at Closing or Pays \$446.62 Difference: \$1,199.95 Note: Difference in proration for Buyer: Receives \$446.62 at Closing or Pays \$753.33 Difference: \$1,199.95						
EXAMPLE - PRORATING A WINTER TAX IN ADVANCE OR ARREARS (January 1 st - December 31 st)						
Taxes In Arrears	Dec. 1 st Levy	November 15 th Closing	Seller's Possession was 10 months 14 days (Jan. - Nov.) (Seller reimburses Buyer)		Buyer's Possession will be 16 days 1 month (Nov. - Dec.)	
\$1200	Buyer will Pay		\$1046.62	\$0	\$0	\$1046.62
Estimated Levy	\$1200		At Closing Seller Pays	At Closing Seller Receives	At Closing Buyer Pays	At Closing Buyer Receives
Taxes In Advance	Dec. 1 st Levy	November 15 th	Seller's Possession was 10 mos 14 days (Jan. - Nov.) (Seller paid for one year and is reimbursed)		Buyer's Possession will be 1 mos 16 days (Nov. - Dec.)	
\$1200			\$0	\$153.28	\$153.28	\$0
Levied Amount	Seller Paid \$1200	Closing Date	At Closing Seller Pays	At Closing Seller Receives	At Closing Buyer Pays	At Closing Buyer Receives
Note: Buyer may also be required to "escrow" enough money to cover the upcoming tax bill in full. Note: Difference in proration for Seller: Receives \$153.28 at Closing or Pays \$1046.62 Difference: \$1,199.90 Note: Difference in proration for Buyer: Receives \$446.62 at Closing or Pays \$753.33 Difference: \$1,199.90						