HONIGMAN

Tax Appeals Alert

September, 2008

STATE TAKING AIM AT TAXPAYERS

Proposals aimed at increasing taxes on commercial property owners, manufacturers and leasing companies are gaining steam in Lansing.

Proposed Expansion Of The Real Estate Transfer Tax. There are two real estate transfer taxes in Michigan, one levied by the state (SRETT) and the other by the counties. Both taxes are now imposed only when ownership of real property is transferred by written instrument. Each tax is based on the "fair market worth" of the property transferred. The State tax rate is $3.75 per $500 (0.75%) and the County tax rate is $0.55 per $500 (0.11%).

Often, properties held by LLCs are transferred by way of selling the shares of the LLC. When these transfers occur and title remains in the name of the LLC, no documents are recorded with the Register of Deeds and no transfer tax is due. HB 6122 was allegedly introduced to impose SRETT liability in that situation.

However, HB 6122 expands the SRETT to apply to a broader range of "transfers." Under the bill, any transfer of a "controlling interest" of a corporation, partnership, association, LLC, trust or any unincorporated entity, would cause the transfer tax to be imposed on Michigan real estate owned by the transferred entity. Controlling interest is generally defined as 80% of the total value of the entity.

While the bill may have been aimed at those LLCs that only own one property, the present version of the bill has a much broader application. Any acquisition of an entity would trigger a SRETT liability for all property owned by the acquired entity. Thus, for example, if 80% of the stock of a corporation owning retail stores or factories were sold, then the tax would be due on all of that entity's real property in the State. This is clearly a major expansion of the tax.

HB 6122 is currently in the House Tax Policy Committee and is likely to be the subject of a House hearing in the near future.

State Tax Commission Staff's Position On Personal Property Classification Misconstrues The Applicable Statute.

Part of the legislative package creating the Michigan Business Tax included a property tax rate reduction for commercial and industrial property, plus a 35% refundable credit for taxes paid on industrial personal property. Obviously these changes have made the classification of property an important issue.

The State Tax Commission ("STC") staff has circulated an "exposure draft" memorandum proposing a number of principles to be used in determining the classification of property. Although the applicable statute is clear that industrial personal property is defined as "all machinery & equipment, furniture and fixtures… on industrial parcels," the staff memo proposes its own unsupported, very different, internally inconsistent, and narrow definitions of "industrial personal property."

The staff memo proposes that sometimes the actual use of the personal property be the determining factor for classification. As a result, even if equipment is located on an industrial site, it would not necessarily be considered "industrial personal property". Inconsistent with its unsupported use test, the staff proposes an equally unsupported position that the personal property of leasing companies be considered "commercial personal property," regardless of where or how the property is used or located. Thus, for example, according to the staff, if a manufacturer leases machinery and equipment located in its manufacturing plant on its industrial real property parcel, then that property is treated as "commercial personal property," which is a less favorable classification for tax purposes than is "industrial personal property." Each of these STC positions, if imposed, would narrow the governing statutory definition of "industrial personal property" and effectively increase taxes for lessors and lessees.

The STC is accepting comments until October 1 on the staff memo. If you have questions about these proposals or would like a copy of the general comments that Honigman submitted to the STC, please contact a member of the Honigman Tax Appeals Department.

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