

Eligible Personal Property Exemptions for Assessors

In December of 2012 Governor Snyder signed into law Public Acts 397 through 403 and 406 through 408 of 2012. These Public Acts significantly changed the taxation of business personal property in Michigan. In October of this year, the Legislature enacted technical amendments to three of these Public Acts. These technical amendment bills became Public Acts 153 and 154 of 2013.

The purpose of today's presentation is to:

- Provide you with a basic understanding of the legislation as a whole.
- Provide you with detailed information relating to those portions of the legislation which will take effect for the 2014 assessment year.
- Alert you to several areas where you may be likely to encounter difficulties in implementing the enactments.

Contrary to the understanding of many taxpayers and assessors, the Acts do not provide for the complete exemption of business personal property. Instead, they provide for exemptions in two separate categories.

The two categories of exemptions are:

- The "Eligible Personal Property" exemption; and,
- Two "Eligible Manufacturing Personal Property" exemptions, one for new "Eligible Manufacturing Personal Property" and the other for previously existing "Eligible Manufacturing Personal Property."

To make these exemption names, which are very similar, less confusing, many people are referring to the "Eligible Personal Property" exemption as the "Small Taxpayer Exemption." This is OK as long as you remember that it is not the official name of the exemption and that it can be misleading in some situations.

The "Eligible Personal Property" exemption takes effect for the 2014 assessment year and exempts the commercial personal property and industrial personal property which a business owns if the business and related entities own, lease and/or possess personal property having a true cash value of less than \$80,000 in that local assessing unit.

The two "Eligible Manufacturing Personal Property" exemptions do not take effect until the 2016 assessment year. They exempt personal property which is used either for "Industrial Processing" or for "Direct Integrated Support" of Industrial Processing. We will defer discussion of those exemptions until the end of this presentation and concentrate initially on the "Eligible Personal Property" exemption, which is of most immediate concern to assessors.

The Public Acts provide that in August of 2014, as part the Michigan primary election process, Michigan voters will decide whether to approve proposed changes to the Michigan Use Tax. These changes are needed to provide partial replacement revenue for the exemptions. If the voters decide not to approve the proposed changes to the Use Tax, then the Acts currently provide that the "Eligible Personal Property" exemption will end after only one year, and that the other "Eligible Manufacturing Personal Property" exemptions will never take effect.

The “Eligible Personal Property” Exemption, Commonly Referred to as the “Small Taxpayer Exemption”

While the other exemptions may be amended for technical reasons before they take effect, the provisions of the "Eligible Personal Property Exemption" are fully established. Assessors must now be prepared to immediately implement the exemption. We expect a great deal of confusion both among taxpayers and among assessors, simply because the exemption procedure is so exacting in terms of eligibility, and time is so short.

As mentioned at the beginning of this presentation, the "Eligible Personal Property" exemption, which we have been referring to as the “Small Taxpayer Exemption,” takes effect for the 2014 assessment year and exempts the personal property which a business owns if the business and related entities own, lease and/or possess personal property having a true cash value of less than \$80,000 in that local assessing unit. If the true cash value of such personal property exceeds \$80,000, then the business does not qualify for the exemption at all.

The exemption applies to personal property which is classified either as commercial personal property or as industrial personal property. Personal property having other classifications does not qualify for the exemption. Requirements for the exemption include:

- The determination of whether the true cash value is less than \$80,000 must be based on all commercial personal property and industrial personal property owned by, leased to, or in the possession of that owner or a related entity in that local assessing unit. Notice that the standard for claiming the exemption is not based solely on the amount (on the true cash value) of the personal property that will be assessable to the owner. It is possible for an owner that is assessed for less than \$80,000 of true cash value of personal property to be ineligible for the “Eligible Personal Property” exemption, arising from the fact that it, or a related entity, leases or possesses personal property that is not assessable to it, but which is considered in determining eligibility for the exemption.
- The legislation provides that an affidavit claiming the exemption for eligible personal property must be filed by February 10th.

- In 2014 only, a taxpayer that has missed the February 10th deadline may claim the exemption at the March Board of Review.
- The personal property statement will continue to be due on February 20.
- The definition of “Eligible Personal Property” considers and includes indirect control situations when determining that the true cash value of the claimant’s personal property is less than \$80,000.
- The legislation defines “control”, “controlled by”, “under common control with”, and “related entity,” in an effort to prevent a taxpayer from gaining exemption by means of titling property in the names of related entities. Included is language which states that there is a “rebuttable presumption” that the “power to vote, directly or by proxy, 10% or more of the ownership interest” or “ownership through attribution” indicates control.
- The phrase "Related entity" means a person that, directly or indirectly, controls, is controlled by, or is under common control with the person claiming an exemption under this section.
- The word "Person" means an individual, partnership, corporation, association, limited liability company, or any other legal entity.
- The exemption is not available to personal property which is leased or used by a person that directly or indirectly controls, is controlled by, or is under common control with the person that previously owned the property. This provision deals with sale and leaseback situations.
- The legislation authorizes an assessor to deny the exemption if the assessor believes that the property does not qualify.
- The legislation authorizes an assessor to retroactively deny an exemption for the current year and the three previous years, and issue a corrected tax bill, plus interest and penalties, if he or she believes that the property was not eligible.

Both Taxpayers and Assessors must be mindful of the following:

- Qualification for the exemption has little or nothing to do with the amount of the taxpayer’s past assessments in the jurisdiction, or even the amount that the taxpayer’s assessment would be for 2013. Instead entitlement to the exemption is determined by adding together the true cash value of the personal property which the taxpayer, or a related entity:

1. Owns,
2. Leases; or
3. Possesses,

in the entire assessment unit.

- In other words, the exemption is granted to taxpayers who own or use a small amount of personal property in the local assessing unit, not to taxpayers who have small assessments because they are leasing or borrowing part of the personal property that they use to conduct their business.
- Even if the taxpayer or related entities would normally file several personal property statements in the assessment unit, for different locations or in different school districts or authority areas, the true cash value of the personal property which is owned, leased or possessed in the assessment unit, is added together to determine whether the taxpayer is entitled to the “Small Taxpayer Exemption.”
- To claim the exemption, the Taxpayer must file Form 5076, *Affidavit of Owner of Eligible Personal Property Claiming Exemption from Collection of Taxes* by February 10th of the assessment year. Except for the 2014 assessment year, the taxpayer cannot receive, and the assessor cannot grant, the Eligible Personal Property exemption unless the taxpayer fully completes and returns the Affidavit to the Assessor, so that it is actually received by the assessor by February 10 of that assessment year. The Taxpayer must file the *Affidavit* every year to continue to receive the exemption.
- If the Taxpayer files a fully completed Form 5076 with the Assessor by February 10th of the assessment year, the Taxpayer is excused from filing a personal property statement for that assessment year.
- For the 2014 assessment year only, if the Taxpayer fails to return the *Affidavit* by February 10th, then the Taxpayer is permitted to petition the March Board of Review for the exemption. To effectively petition for the exemption, the taxpayer must complete both the March Board of Review protest form and submit the completed Affidavit Form 5076. The taxpayer may also wish to present a completed personal property statement along with the Affidavit Form 5076 to the 2014 March Board of Review so that the Board can consider the statement in setting the assessment if it decides that the assessor’s denial of the exemption was correct.
- If the exemption is denied by the assessor, then that denial may be appealed to the March, July or December Board of Review, and the taxpayer may also appeal to the Michigan Tax Tribunal.

- A significant area of concern to assessors should be the reporting by taxpayers, and processing by assessors of, “Trade Fixture” and “Leasehold Improvement” costs.
 1. *Trade Fixtures* are items attached to real property by a tenant, which the tenant has the right to remove at the end of the lease term and which can be detached for use elsewhere without destroying the item in question. Under Michigan Law, if the lease is silent, the tenant has the right to remove such items. Most leases do not prevent the removal of trade fixtures. Trade fixtures do not become part of the real property and, instead, they remain personal property. MCL 211.8(k) specifically provides that trade fixtures are assessable as personal property. The true cash value of trade fixtures must be included in determining whether the tenant is eligible for the “Small Taxpayer Exemption.” A difficulty is that taxpayers frequently record trade fixture costs in the leasehold improvement section of their fixed asset accounting records, and then report them as leasehold improvements rather than as personal property.
 2. *Tenant installed leasehold improvements* are improvements to the land or structures of the landlord which have been made by the tenant. They are distinguished from trade fixtures by the fact that the leasehold improvements cannot be removed for use elsewhere without destroying them. During the tenancy of the lessee, *tenant installed leasehold improvements* may be assessed to the tenant, to the extent that the improvements add to the value of the real property and are not included in the assessment of the real property.
 3. Leasehold improvements may be assessed as personal property pursuant to MCL 211.8(h) (unless the lease existed before 1984 and has not been substantially renegotiated since). In the alternative, leasehold improvements may be assessed to the real property interest of the landlord, based on the fact that they are really improvements to real property, not personal property at all.
 4. In summary, trade fixtures must be assessed as personal property to the tenant, and leasehold improvements may be assessed either as personal property to the tenant or as real property to the landlord. However, leasehold improvements are essentially real property in nature.
 5. If leasehold improvements are assessed as personal property then they may prevent the tenant from qualifying for the “Small Taxpayer Exemption.” On the other hand, changing the assessment of previously assessed leasehold improvements from the tenant to the landlord may result in resistance from the landlord, who might claim that they are not proper capped value additions. The ability of an assessor to change the assessment of leasehold improvements from the tenant to the landlord in a

subsequent year, and then treat the change as a capped value addition, has not been tested in the Tax Tribunal.

6. Taxpayers generally have difficulty in distinguishing trade fixtures from leasehold improvements, particularly since they often book trade fixtures in their leasehold improvement asset accounts. This failure to discern the difference between trade fixtures and leasehold improvements may result in them mistakenly failing to consider the true cash value of trade fixtures when determining the true cash value of their personal property, when completing Affidavit Form 5076. Further, taxpayers might exclude leasehold improvements which have been assessed to them in the past when considering whether they qualify for the “Small Taxpayer Exemption,” based on a claim that the improvements are not personal property.
- Another significant area of concern to assessors should be the methods being used by taxpayers in calculating the true cash value being used to determine whether the taxpayer qualifies for the exemption. These concerns include the following:
 1. Many taxpayers will not understand that they must add together the true cash values of *all* the personal property used in *all* of their *business locations* in the assessment unit, whether *owned, leased or possessed by a related party or owned, leased or possessed by the taxpayer itself*.
 2. Taxpayers may have difficulty in calculating true cash value for the personal property they own and for the personal property owned by related entities. Most taxpayers are not particularly familiar with the use of the State Tax Commission recommended valuation procedures for personal property.
 3. Taxpayers will have particular difficulty in determining the true cash value of personal property which they or a related entity are leasing or which is possessed, but not owned, by the taxpayer or a related entity.

The legislature intended that the affidavit small taxpayers are required to submit, Affidavit Form 5076, would be simple and easy to understand. Unfortunately, the legislation provided for assessors to administer the “Small Taxpayer Exemption” is not simple or easy. Assessors should carefully review and fully understand Affidavit Form 5076.

In order for a taxpayer to receive the exemption, it must fully complete Affidavit Form 5076. We draw your attention to several aspects of the form:

- The Taxpayer is notified that to be eligible for the “Eligible Personal Property” exemption (the “Small Taxpayer Exemption”) the true cash value of all commercial personal property and industrial personal property owned by, leased

to, or in the possession of that taxpayer or a related entity in that local assessing unit must be less than \$80,000.

- Notice that although all of the personal property in the local unit which is owned, leased or possessed by the taxpayer or related entities is considered when determining the taxpayer's entitlement to the exemption, only the property owned by the taxpayer is exempted. The personal property of lessors and other owners of the property considered in determining the exemption for that taxpayer is not exempt unless those lessors or owners separately qualify for the exemption based on the property which they and related entities own, lease or possess in the local assessing unit.
- The Taxpayer is required to indicate how it has computed the true cash value of its personal property for purposes of determining that the true cash value of its personal property is less than \$80,000.
- The Taxpayer is required to indicate whether it has included the true cash value of trade fixtures when it determined that the true cash value of its personal property is less than \$80,000.
- The Taxpayer is required to indicate whether it has included, or excluded, the true cash value of its leasehold improvements for purposes of determining that the true cash value of its personal property is less than \$80,000.

The Acts also provide for the following with respect to the exemption for "Eligible Personal Property,"

- Make it a misdemeanor for a person to fraudulently claim an exemption.
- Require assessing officers to notify taxpayers of the availability of the exemption.
- Require a person claiming an exemption to maintain adequate books and records and provide access to them for audit purposes.
- Requires assessors to preserve Affidavit Form 5076 that have been filed by taxpayers for four years.
- Permit the denial of an exemption by the assessor to be appealed to the March Board of Review or the July or December Board of Review for that year.
- Allow a person claiming an exemption to appeal a Board of Review's decision to the Michigan Tax Tribunal.

Areas of Particular Difficulty

Calculating True Cash Value

Determining True Cash Value for Leased or Possessed Personal Property

Distinguishing between Real Property and Personal Property

Lack of rigorous application, or rigorous application, of the three part test by the Tax Tribunal.

The identification of Trade Fixtures

The Identification of Installation Costs for Machinery and Equipment.

The handling of Leasehold Improvements.

The handling of property which the Michigan Legislature or State Tax Commission has indicated is personal property.

Overview of All the Changes

Up to this point, everything which we have discussed is applicable to the 2014 assessment year. I will now provide an overview of all the changes so that you will be prepared to address questions and misunderstandings of your local officials and taxpayers.

As I mentioned previously, the "Small Taxpayer" exemption is the only one of the three exemptions which is effective for the 2014 assessment year. However, subject to voter approval, sections 9m and 9n of the General Property Tax Act, which are found at MCL 211.9m and MCL 211.9n, respectively, provide for the future exemption of "Eligible Manufacturing Personal Property."

Under Section 9m, "Qualified New Personal Property", which is "Eligible Manufacturing Personal Property" that was initially placed in service, either inside or outside Michigan, after December 31, 2012, is exempt for assessment years after 2015. That is to say, the exemption for "Eligible Manufacturing Personal Property" initially placed in service after 2012 takes effect for the 2016 assessment year.

Beginning in 2016, Section 9n exempts "Qualified Previously Existing Personal Property", which is "Eligible Manufacturing Personal Property" placed in service before January 1, 2013, after the personal property has been subject to, or could have been subject to, taxation for 10 years. The exemption applies regardless of whether the personal property in question ever has been assessed in Michigan. This means that any property which "could have been taxed" for more than 10 years before a given tax day is

exempted by Section 9n, even if it was exempt, or located outside of Michigan, during all or part of the ten year period.

This means that “Eligible Manufacturing Personal Property” that first “could have been taxed” to its first owner in assessment year 2006, or an earlier year, will be exempt beginning in 2016. Subsequently, “Eligible Manufacturing Personal Property” that first “could have been taxed” to its first owner in 2007 will be exempt beginning in 2017, and so on until “Eligible Manufacturing Personal Property” which first “could have been taxed” to its first owner in 2013 will be exempt beginning in 2023, at which time all “Eligible Manufacturing Personal Property” will be exempt.

“Eligible Manufacturing Personal Property” is defined as all commercial or industrial personal property located on Occupied Real Property if that personal property is used more than 50% in industrial processing or direct integrated support.

Notice that for purposes of the exemption for "Eligible Manufacturing Personal Property," either all of the personal property located on “Occupied Real Property,” or none of the personal property located on “Occupied Real Property,” is exempt. The determination of whether the use is more than 50% in “Industrial Processing” or “Direct Integrated Support” is based on a formula that compares the cost new of the personal property used in “Industrial Processing” or “Direct Integrated Support” with the cost new of all of the personal property at the site, and then develops proportions based on the amount of use of the qualified personal property for “Industrial Processing” or “Direct Integrated Support.”

Personal property at locations where the “greater than 50% use” test is not met will continue to be assessed, unless it is “Eligible Personal Property” (subject to the “Small Taxpayer Exemption”).

The current definitions of "Industrial Processing," "Direct Integrated Support," and “Occupied Real Property” stated in summary fashion, are as follows:

"Industrial processing" means that term as defined in section 4t of the general sales tax act, 1933 PA 167, MCL 205.54t, or section 4o of the use tax act, 1937 PA 94, MCL 205.94o. See Treasury Revenue Administrative Bulletin 2000–4 which can be found by going to the the Michigan Department of Treasury home page, www.michigan.gov/treasury and clicking on Revenue Administrative Bulletins on the right side. MCL 211.9m and the other statutes cited provide that industrial processing does not include the generation of electricity for sale but does include the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination, or character of the property for ultimate sale at retail and begins when tangible personal property begins movement from raw materials storage to begin industrial processing and ends when finished goods first come to rest in finished goods inventory storage.

"Direct integrated support" activities are activities in furtherance of industrial processing which are:

- Research and development.
- Testing and quality control functions.
- Engineering related to goods produced in industrial processing.
- Receiving or storing of equipment, materials, supplies, parts, components or of scrap materials or waste.
- Storing of finished goods inventory.
- Sorting, distributing, or sequencing functions that optimize transportation and just-in-time inventory management.

“Occupied Real Property” means real property that is owned, leased, or otherwise occupied by a person claiming the exemption or by an affiliated person, and can be part of a parcel of real property; a single parcel of real property; or contiguous parcels of real property that host a single, integrated business operation engaged primarily in industrial processing, direct integrated support, or both.

These descriptions of "Industrial Processing" and "Direct Integrated Support" personal property are merely summarized. The exact definitions can be found in MCL 211.9m.

An exemption for “Qualified New Personal Property” and for “Eligible Manufacturing Personal Property” may be claimed for personal property located on real property owned by, leased to, or occupied by the person claiming the exemption or on real property owned, leased or occupied by an affiliated person.

The local assessor is authorized to deny the exemption for the current year only if he or she believes that the property was not eligible and to send a revised tax bill, along with a notification to the claimant of its right to protest to the board of review and, if the protest is denied, of its right to appeal to the Tax Tribunal. The Acts provide for criminal penalties for fraudulently claiming the exemption.

Industrial Facilities Tax (IFT) personal property which is subject to specific taxation for 2013 and that also meets the definition of “eligible manufacturing personal property,” will remain subject to the specific tax until the “Eligible Personal Property” or “Eligible Manufacturing Personal Property” exemption applies. This provision may allow the IFT exemption to continue beyond its normal expiration date.

For personal property that is exempt for 2013 under MCL 211.9f (PA 328) that also meets the definition of “Eligible Manufacturing Personal Property,” the PA 328 exemption will remain in effect for either the term of the PA 328 exemption, or the year the property becomes eligible for an “Eligible Manufacturing Personal Property” exemption, whichever is later.

Beginning in 2016, local units, including counties, cities, villages and townships, can, without a vote of the people, enact special assessments for "Essential Services," which

include ambulance, fire, police and jail services. This special assessment is imposed on each parcel of industrial or commercial real property which has exempt eligible manufacturing personal property located thereon, at the rate needed to replace property taxes used to pay for essential services lost by the “Eligible Manufacturing Personal Property” exemption. However, the assessment cannot be greater than the amount of personal property tax for essential services which would have been paid. A taxpayer must claim the applicability of this limit by filing an affidavit within 30 days of the date that the special assessment is assessed.

The legislation creates a Metropolitan Areas Metropolitan Authority (MAMA) which will both receive funds appropriated by the legislature and levy the "Metropolitan Areas Components Tax" (a local use tax levied against certain activities or transactions, which is currently levied by the State). MAMA is required to distribute the revenue from the tax, starting in State fiscal year 2015-16.

For 2014 and 2015 only, the MAMA will reimburse for 100% of the debt millage losses for all local units. Beginning for 2016, the authority will reimburse for 100% of the school debt losses and all ISD losses, but for other non-essential services losses, the authority will reimburse “qualified” local government units for only an estimated 80% of their losses. Tax Increment Finance (TIF) obligations are included in the definition of debt millage.

The local units which qualify for this reimbursement include counties, cities, villages, townships, authorities, local school districts, intermediate school districts, community college districts, libraries, and local and intergovernmental taxing units but they are not eligible unless they have a minimum dependence on the personal property tax revenue (currently set at a 2.3% reduction of unit’s taxable value). This minimum dependence requirement does not apply to community colleges and these colleges will all receive reimbursement.

The local unit must be able to identify both the 2013 and the current year taxable values of its *commercial and industrial* personal property in order to calculate and claim reimbursement for the loss of revenue caused by the "Eligible Personal Property" exemption. While this information is readily available for cities, counties, townships, schools and ISDs, it may be less accessible for villages, community colleges and governmental authorities, unless efforts are made to preserve the data. The determination of the “as of” date for the calculation of the taxable value of commercial and industrial personal property, and the date that reimbursement will be made to the local unit, have not yet been determined.

The Acts also provide that the State must fund the MAMA Authority sufficiently to meet its payment obligations, and that the appropriations will be required even if the ballot question referred to in a moment is defeated.

Beginning in 2017, the reimbursements for personal property losses will be phased out over 20 years and replaced with payments based on taxes levied on industrial real property where exempt eligible manufacturing personal property is located.

Technical amendments will likely be adopted to reimburse TIF plans and to make other changes to the “Essential Services Assessment” and required reimbursements.

The partial replacement revenue that will be distributed by MAMA is intended to be taken from diversion of a portion of the State Use Tax to fund a Local Use Tax levied by the MAMA. The Local Use Tax levy is set at the amount necessary to generate the dollar amount set in the use tax act, and the State Use Tax is reduced by the amount of Local Use Tax which is generated. These provisions require a vote of the Michigan electors in August of 2014. A portion of the State Use Tax is earmarked to reimburse school districts for the exempted operating tax and these funds will be distributed to the School Aid Fund and directly to out-of-formula school districts.

The results of the vote on the August 2014 ballot question will determine whether most of the amendments or the new acts will take effect, or remain in effect. The Acts will be repealed, or will no longer be effective, if the ballot question is defeated, except that the “Small Parcel Exemption” will remain in effect for 2014 only.