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LEASEHOLD IMPROVEMENTS; AUDITOR GENERAL AMENDMENTS

**Senate Bill 914 (Substitute H-2)
First Analysis (12-12-02)**

**Sponsor: Sen. Thaddeus G. McCotter
House Committee: House Oversight and
Operations
Senate Committee: Government
Operations**

THE APPARENT PROBLEM:

Public Act 415 of 2000 amended the General Property Tax Act to specify that, generally speaking, for taxes levied after December 31, 2002, buildings and improvements on leased land are to be taxed as real property to their owner. Prior to this, buildings and improvements on leased land were considered personal property. The administration of this new treatment of leasehold improvements has caused concern among assessors. They believe the procedures for assessing leasehold improvements will be confusing for assessors (as well as for landlords and tenants). Treating leasehold improvements as separate parcels of real property to be assessed to the owner will be a cumbersome and complicated task. Reportedly, significant data processing changes will be needed and new parcel identification numbers and labels will have to be developed. There also could be conflicts over who the "owner" is of such property. Ownership in a particular case might depend on the interpretation of the language of the lease, for example. Businesses will also be forced to distinguish for assessment purposes between leasehold improvements of a real property nature and trade fixtures, which will continue to be classified as personal property. This could prove troublesome.

(According to information from the Department of Treasury, trade fixtures, generally speaking, are those items installed by the tenant required by the tenant's business and removable at the end of the tenancy (such as signs, removable wall coverings, telephone and security systems, and custom made lights). Leasehold improvements of a real property nature include such things as floors, walls, permanent storefronts and wall finishes, and mechanical systems. Trade fixtures would remain as personal property, while leasehold improvements of a real property nature would be real property, under state tax officials' interpretation of Public Act 415.)

In another matter, as part of the rewriting of the state constitution in 1963, the office of auditor general was converted from an elected position to a position appointed by the legislature. The 1963 constitution requires the auditor general to conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state, and to conduct performance post audits of those entities. It also authorizes the auditor general to make investigations pertinent to the conduct of audits, and requires the auditor general to report annually (and at other times as considered necessary) to the legislature and the governor. The constitution says that the auditor general "shall be assigned no other duties than those specified" in the constitution (Article 4, Section 53).

Accordingly, the Executive Organization Act of 1965 transferred all of the powers of the auditor general (except those granted under the constitution) to the Department of Treasury. However, many statutes that refer to the auditor general were never amended to reflect these changes.

THE CONTENT OF THE BILL:

Senate Bill 914 would amend the General Property Tax Act to strike the provision that says, "For taxes levied after December 31, 2002, leasehold improvements and structures installed and constructed on leased real property . . . shall be assessed as real property . . . to the owner of the leasehold improvements or structures . . . if the value of the leasehold improvements or structures is not otherwise included in the assessment of real property or otherwise assessable". As a result, during the tenancy of a lessee, the improvements and structures installed and constructed on real property by the lessee would be classified as personal property and

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would be assessed to the lessee (tenant). Further, the bill would require, for taxes levied after December 31, 2003, that the assessor separately state the assessed value and tentative taxable value of any leasehold improvements on the assessment roll and on notices to taxpayers.

(Buildings on leased land would be treated as real property after December 31, 2002, as provided for in Public Act 415 of 2000. The bill contains some provisions regarding how such buildings are to be classified. For example, agricultural real property would include buildings on leased land used for agricultural operations; buildings on leased land used for commercial purposes would be classified as commercial property; and a home, cottage, or cabin on leased land would be classified under residential real property.)

The bill also would specifically classify “trade fixtures” as personal property, for taxes levied after December 31, 2002. The term “trade fixture” would be defined to mean property attached on or in real property that met all of the following criteria: 1) was attached to the real property primarily for business purposes or for business operations conducted on or in the real property and not to improve the functional utility of the real property as a whole; and 2) was removable without damaging the real property. The bill also provides a definition of “fixtures on the land”, which would refer tangible property attached to the land that is primarily intended to improve the functional utility of the land as a whole and is not primarily intended for business purposes or for business operations conducted on land.

The bill also contains a provision, unrelated to the leasehold improvement sections, that would include the taxable value, if any, of some kinds of property owned by a county, township, city, village, or school district [that was not exempt from property taxes] in the taxable value of other real property located in the county, township, city, village, or school district. The property in question would include parks, cemeteries, markets, and other buildings and grounds.

In addition, the bill would amend the act to replace references to the auditor general with references to the state treasurer in provisions concerning the administration of the property tax.

MCL 211.35 et al.

HOUSE COMMITTEE ACTION:

As passed by the Senate, the bill dealt only with removing the obsolete references to the auditor general throughout the General Property Tax Act. The Committee on House Oversight and Operations adopted a substitute for the bill, Substitute H-2, incorporating the changes proposed by the Michigan Assessors Association with regard to the implementation of Public Act 415 of 2000.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the changes dealing with obsolete references to the auditor general would have no fiscal impact. (12-9-02)

ARGUMENTS:

For:

Treating leasehold improvements as real property, as is newly required by Public Act 415 of 2000, would be an administrative burden for assessors. The bill would treat leasehold improvements as personal property, as is currently the case. (Public Act 415 applies to taxes levied after December 31, 2002.) The bill also would require that leasehold improvements be separated out on assessing forms, which business representatives say will help to ensure that they are valued fairly. The bill also puts into statute definitions of “trade fixtures” and “fixtures on the land” to provide guidance on the meaning of these terms for businesses and assessors alike.

Response:

State tax officials are concerned about putting new definitions for “trade fixtures” and “fixtures on the land” into statute. These terms have common law and case law meanings. More time is needed to determine if the definitions in the bill are adequate.

For:

The bill would delete many references in the General Property Tax Act that have been obsolete since the office of auditor general became an appointed position with the adoption of the 1963 state constitution. The functions referred to in many of the provisions of the act have long since been transferred to the treasury department. With many citizens now using electronic search engines and Internet access to obtain information about state government, these outdated references simply serve to confuse people, and they should be removed from the compiled laws.

POSITIONS:

The Department of Treasury supports making leasehold improvements personal property but has concerns about other aspects of the bill, particularly the definitions of trade fixtures and other fixtures. (12-11-02)

The Michigan Assessors Association supports the bill. (12-10-02)

The Michigan Chamber of Commerce supports the concept of the bill as long as it continues to contain the provision separating leasehold improvements out on assessment statements, and it wants the definitions of trade fixtures and other fixtures kept in the bill. (12-11-02)

The Office of the Auditor General supports the provisions of the bill that would remove obsolete references to the auditor general from the property tax act. (12-10-02)

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.