

Avoid Uncapping Forever – Or Not

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Since Michigan adopted Proposal A in 1994, the annual increase in the value used to determine a parcel's real property taxes is capped at either 5 percent or the rate of inflation, whichever is less. This cap continues so long as there is no "transfer of ownership," a term that has a complex and somewhat opaque statutory definition.

When a transfer of ownership does occur, the property tax value is "uncapped" and is once again based on the fair market value of the parcel. For property that has been held by the same owner for many years, the cap can result in a significant savings in property taxes. Therefore, managing when and if a transfer of ownership will occur is an important consideration.

A pair of unexpected and taxpayer-friendly court decisions suggest that uncapping can potentially be avoided indefinitely. These recent cases, *Klooster v. City of Charlevoix* and *Taylor v. City of Traverse City*, both involved a father who deeded real property to himself and his child as joint tenants shortly before the father's death. This is a common scenario (though sometimes ill-advised, as discussed later in this article).

Prior to these cases, the conventional understanding of transfer of ownership rules was that the property taxes would uncap at the father's death. That's when the child, as surviving joint owner, would take sole ownership of the property. The Michigan Tax Tribunal had followed that approach in its rulings, but, on appeal, the Michigan Court of Appeals reversed the tribunal's decisions and determined that there was no uncapping as a result of the father's death.

The Court of Appeals reached this conclusion because, in its view, the word "conveyance" – as used in the transfer of ownership rule that applies to terminating a joint tenancy – implied a written instrument affecting title. Because the property in these cases had passed automatically to the child at the father's death without any further written instrument, the transfer of ownership criteria had not been met, the Court of Appeals held.

While the *Klooster* and *Taylor* decisions stop short of stating that uncapping cannot occur unless there is a written instrument of transfer, they do provide a roadmap for avoiding uncapping through joint ownership. If a property owner adds a child or other close relative as a joint tenant, and then, after the death of either joint owner, the survivor does the same, the property taxes could potentially remain capped forever, according to the logic of these cases.

So everyone should start adding children as joint owners of their real property, right? Not so fast. It is important to note that this issue is now being appealed to the Michigan Supreme Court, which could reverse these taxpayer-friendly decisions. Even if the decisions are ultimately upheld, the legislature will likely attempt to amend the property tax statute to close this loophole.

More importantly, there are some inherent dangers associated with joint ownership. Those dangers could potentially outweigh any potential property tax benefits suggested by the *Klooster* and *Taylor* cases. Adding a joint owner subjects the property to the claims of the new joint owner's creditors. Do you want a lawsuit against your child to result in the loss of your residence? Adding a joint owner on your property also constitutes a gift for federal tax purposes. Depending on the value of the property and the number of joint owners, this likely imposes an obligation to file a federal gift tax return and could potentially result in gift tax liability. Finally, adding a joint owner can skew the distributions provided in your estate planning documents because jointly-owned assets will pass without regard to the terms of your will or trust. Far too often, joint ownership arrangements are created without considering these potential traps.

The *Klooster* and *Taylor* decisions are an unexpected development in Michigan property tax law, but caution should be exercised, and competent counsel consulted, whenever creating or terminating joint ownership arrangements. If you have questions about these cases, property tax uncapping or other tax issues, contact a member of Warner's Trusts and Estates group.