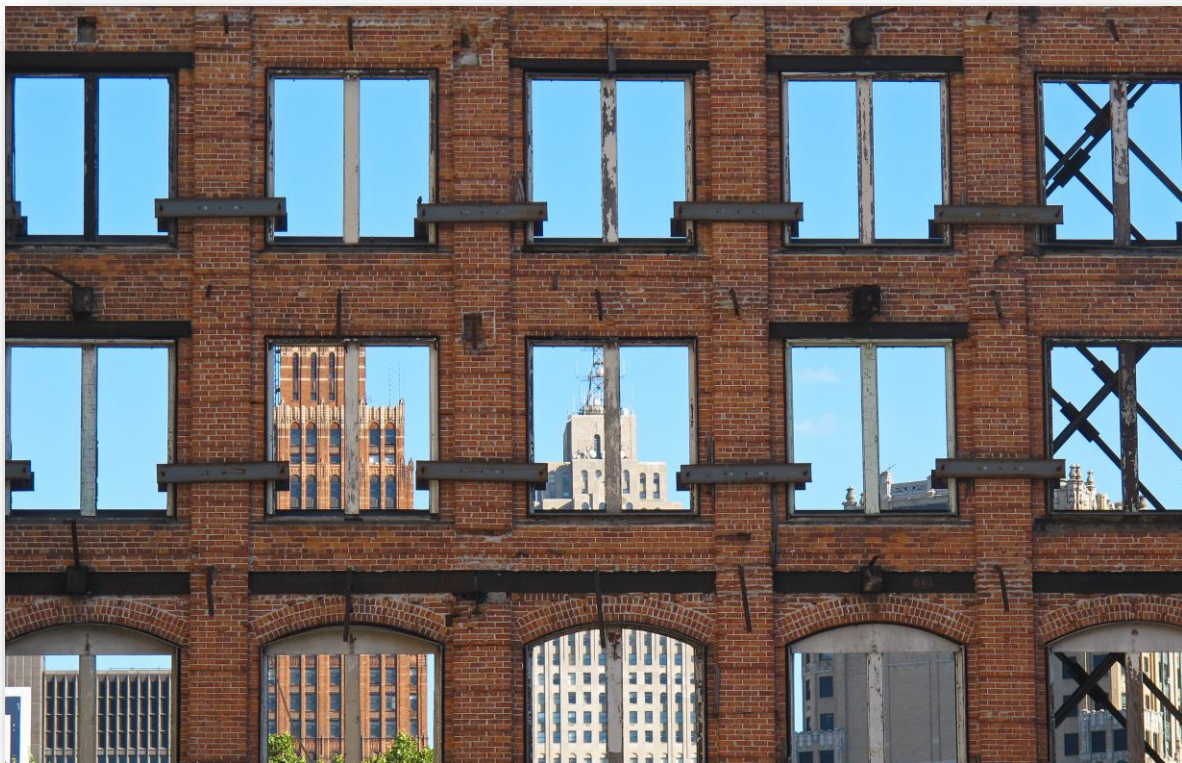




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# INTERNATIONAL LAWYERS NETWORK



**HOWARD & HOWARD**

Buying and Selling Real Estate in Michigan

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**ILN REAL ESTATE GROUP**

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## KEY FACTS OF REAL ESTATE ACQUISITIONS UNDER MICHIGAN LAW

### I. STANDARD FORMS OF AGREEMENTS

- A. Offers to Purchase that are accepted by sellers are the typical form of purchase contract for residential properties. The offer, often negotiated before being signed by all parties, typically sets forth the offered price, proposed closing date, buyer's inspection and financing contingencies, type of deed conveyance (warranty, special or quit claim), and certain other terms of the transaction. Any proposed change by seller to the buyer's offer is considered a counteroffer.
- B. Negotiated Purchase and Sale Agreements are typically utilized when commercial or industrial properties are bought and sold.

### II. BROKERS

- A. Buyers and sellers are not required to use a real estate broker or real estate salespersons (a/k/a agents) in connection with the sale of real estate. All real estate brokers and agents must be licensed by the state of Michigan. All real estate agents, while being licensed themselves, must be associated with a licensed broker.
- B. In most residential transactions, the broker and agent must disclose which party they are representing. Brokers and agents may, through a statutory dual agency disclosure, represent both the buyer and the seller in a residential transaction.
- C. In the typical transaction, the seller pays its broker a full commission and seller's broker will share that commission with the buyer's broker, if any.

### III. BUYER'S INSPECTIONS

- A. Residential. It is typical that a buyer is provided with a 5 to 7-day window to have the property inspected. The skill level of residential home inspectors varies greatly. Inspectors should review the structural elements, roof, windows, soundness of foundation, mechanical equipment (AC and heating units, hot water tanks, etc.) and check for radon gas, asbestos, and pest infestation. In older homes, especially in rural areas, the inspection should look for old fuel oil tanks that can lead to environmental issues if they were not properly closed. It is wise to hire an attorney to review the seller's title to the property and that review (whether or not an attorney is hired) is much more definitive if a survey of the property is obtained (showing encroachments, easements or restrictions that might affect the ability to add on to the home later, etc.).
- B. Adverse Possession/Boundary Disputes. A survey obtained during the inspection period should assist in determining any potential adverse possession claims or boundary line disputes (e.g., encroachments by a fence, a shed, etc.). Adverse possession and acquiescence to a particular boundary line may happen after 15 years of uninterrupted possession (or location of a fence or boundary marker). A boundary line can be re-established by agreement (through conduct or writing) without a 15-year waiting period.
- C. Private Septic. If the property is on a private septic system (rather than a



municipal sewer), then, depending on the locale, a certificate of inspection from the local municipality or health department may be required.

- D. Seller’s Disclosures. For improved residential property, the seller is required to provide a seller’s disclosure statement where the seller discloses certain conditions (water infiltration, condition of heating unit, etc.) of which it is aware. For houses built before 1978, a lead paint disclosure is also required.
- E. Certificates of Occupancy and Building Permits. Some cities and townships require that a home be inspected to verify that it meets the applicable building codes before it can be sold. If code violations are cited, the parties often negotiate a price reduction if the seller is not willing or able to cure the violation(s). A buyer should also check the municipality building department to determine if there are any open permits for work that have not been approved through a final inspection.
- F. Commercial: In addition to the inspections performed by residential buyers, commercial buyers also usually obtain a survey, an environmental review, and a use and zoning and/or permit compliance review. Depending on the municipality, a certificate of occupancy may also be needed before commercial property can be transferred. If commercial tenants occupy the premises, a thorough review of the leases is advised (buyers are advised not to rely on rent rolls or lease summaries) and it is not uncommon for commercial leases to contain a right of first refusal to buy the property that must be

complied with or waived before a sale can proceed. A certificate from the commercial tenants certifying the exact lease and all amendments thereto and that the seller-landlord is not in default are often obtained as part of the due diligence.

**IV. FORMS OF OWNERSHIP**

- A. Typically, residential property is held in a trust or an individual’s name. If held in a trust, the trust may be either irrevocable or revocable. Irrevocable trusts typically cannot be modified or terminated by the grantor without the consent of all of the beneficiaries or court approval. In Michigan, trusts are generally governed by the Michigan Trust Code, MCL 700.7101 *et seq.* Joint owners to property may take title as:
  - 1. Tenants in Common. Tenants in common each hold a separate and distinct interest in property but share a right of possession. There is no right of survivorship. In other words, if property is owned by two individuals, and one individual dies, the deceased’s interest reverts to his or her estate, and not the other owner.
  - 2. Joint Tenants. Joint Tenants hold equal and undivided interests in property, with a right of survivorship. In other words, if property is owned by two individuals, and one individual dies, the deceased’s interest reverts to the other owner of the property.
  - 3. Tenants by the Entirety. A married couple can hold real property as tenants by the entirety, where each spouse holds equal and undivided



interests in the real property, with rights of survivorship.

- B. Commercial property may be held as follows:
1. By an individual pursuant to the forms set forth in IV A. above (not recommended for liability purposes).
  2. General Partnership (“GP”)/Joint Venture.
  3. Limited Partnership (“LP”).
  4. Limited Liability Partnership (“LLPs”).
  5. Limited Liability Company (“LLCs”) (most common).
  6. Corporation:
    - (i) C corporation; or
    - (ii) S corporation.

## **V. TREASURY REGULATIONS**

- A. Under Treas. Reg. §301.7701-1 *et seq.*, corporations are always classified as corporations for federal income tax purposes. On the other hand, GPs, LPs, LLCs (with more than one member), and LLPs are classified as partnerships for federal income tax purposes, unless they elect to be taxed as corporations.
- B. C corporations are subject to a “double” income tax because they are taxed at the corporate level, and shareholders are taxed on the dividends they receive from the corporation. Subject to certain exceptions, S corporations are generally taxed only at the shareholder level. Partnerships and LLCs pass through their income and losses to the partners of the partnership. All entities except for C corporations generally avoid double taxation.

## **VI. DISTINGUISHING FEATURES**

### **A. GP/Joint Venture**

1. A partnership is an association of two or more persons to carry on as co-owners of a business for profit. MCL 449.6. A partnership is a distinct legal entity, separate from its owners.
2. GPs (sometimes referred to as copartnerships) generally must file a certificate of partnership in the county where the partnership conducts its business. MCL 449.101.
3. A joint venture is a partnership which is limited to a specific duration or scope.
4. GPs are governed by the Michigan Uniform Partnership Act, MCL 449.1 *et seq.* (“MUPA”).
5. Although not required by statute, it is strongly recommended that partnerships have a Partnership Agreement. A Partnership Agreement sets forth the duties and obligations of the partners towards one another and to the partnership. Absent a Partnership Agreement, the MUPA creates default rules governing the relationship between partners. For example, absent an agreement to the contrary, the MUPA provides that partners will share equally in the partnership’s profits and losses, and that all partners have equal rights in the management of the partnership. MCL 449.18 (a); MCL 448.18(e).
6. Absent a Partnership Agreement to the contrary, partnership interests are generally transferable. However,



the transfer of an ownership interest in a partnership only transfers the right to receive distributions, and not any other rights of ownership (including the right to participate in management). MCL 449.27.

7. The withdrawal of a partner dissolves the partnership. MCL 449.29

8. Advantages

- 1. A partnership is a pass-through entity. The partnership passes through its profits and losses to the partners and there is no entity level income tax.
- 2. Partnerships can be informal, depending on the partnership agreement (or lack thereof).

9. Disadvantages

- 1. Partnerships are not limited liability entities (like a LLC or a corporation). The partners of a partnership are jointly and severally liable for partnership liabilities. MCL 449.15.

Conveyancing issues:

- (i) Any partner of a partnership may generally convey title to partnership real estate (*i.e.*, title to the real estate is in the partnership’s name). A purchaser may rely on a deed signed by any partner, so long as the partner who executed the deed is carrying on in the usual way of business of the partnership, unless (i) the conveying partner lacks the authority to make the conveyance, and

- (ii) the purchaser has actual knowledge of the fact that the conveying partner lacks such authority. MCL 449.9.

- (ii) If title to real estate is in the name of multiple partners in their individual capacities, all such partners must sign the deed.

2. Fiduciary Duty. Partners have a duty to render true and full information to the partnership. MCL 449.20.

B. LPs

- 1. A LP is a statutory entity governed by the Michigan Revised Uniform Limited Partnership Act (“MRULPA”), MCL 449.1101 *et seq.* The MUPA also applies to LPs, except to the extent that it conflicts with the MRULPA.
- 2. In order to form a LP, a Certificate of Limited Partnership must be filed with the Michigan Department of Licensing and Regulatory Affairs (“LARA”). MCL 449.1201(a).
- 3. A LP must have at least one general partner and one limited partner. MCL 449.1101(8). General partners have managerial authority over the business. Limited partners are generally not liable for the obligations of the partnership, unless (i) the limited partner is also a general partner or, (ii) the limited partner takes part in the control of the business. MCL 449.1303(a).
- 4. Certain actions may require approval of the limited partners.



5. A written limited partnership agreement is not required but strongly recommended.

6. Advantages

1. The limited partners of the partnership have limited liability. MCL 449.1303(a).
2. A LP is a pass-through entity. The LP passes through its profits and losses to the partners and there is no entity level income tax.

7. Disadvantages

1. Full liability for general partners, however, a limited liability entity, such as an LLC or a corporation, can serve as a general partner. MCL 449.1403.
2. A limited partner who takes part in the control of the business may be subject to unlimited liability. MCL 449.1403(a). A limited partner who “knowingly permits his or her name to be used in the name of the limited partnership”, except under certain circumstances permitted by statute, is liable to creditors of the LP, provided that the creditors do not have actual knowledge that the limited partner is not a general partner. MCL 449.1303(d).

C. LLP

1. Similar to GPs, except with more limited liability for partners. Specifically, except for certain carve outs, a debt, obligation, or other liability of a LLP is solely the debt, obligation, or other liability of the registered LLP. MCL 449.46(1).

However, a partner in a registered LLP will be liable for the partner’s own negligence, wrongful acts, omissions, misconduct, or malpractice, or that of any individual who is under the partner’s direct supervision and control, that results in a debt, obligation, or other liability of the registered LLP. MCL 449.46(2).

2. Partners in a LLP have some liability protection, but not as much protection as limited partners in a LP.
3. Must file an application to register a LLP with LARA.

D. LLCs

1. Governed by the Michigan Limited Liability Company Act, MCL 450.4101 *et seq.* A LLC must file Articles of Organization with LARA. MCL 450.4202.
2. LLCs are very flexible and can be tailored to the needs of the members. LLCs can be member-managed or manager-managed. Profits, losses, and distributions can generally be divided in any manner agreed upon by the members with certain restrictions.
3. LLCs receive pass through income tax treatment unless the LLC elects to be taxed as a corporation or is a disregarded entity.
4. A written Operating Agreement is unnecessary, but strongly recommended. This document describes how the LLC will be managed and operated. Operating Agreements can be drafted in a



manner that best suits the needs of the company and its members.

draft a complex operating agreement.

5. Advantages

1. Unless otherwise provided by law or in an operating agreement, the members and managers of a LLC have limited liability. MCL 450.4501(4).
2. There is no entity level income tax on a LLC. The profits and losses of the partnership are passed through to the members.
3. LLCs have fewer statutory requirements than a corporation and are generally more flexible.
4. There are very few statutory requirements concerning what must be contained in an Operating Agreement. Operating Agreements can be as simple or as complex as the members desire. However, Operating Agreements generally cover issues like management, membership, income or loss allocations, cash and property distributions, mandatory and permissive capital contributions, dilution, and transferability of ownership, among others.
5. The Operating Agreement can limit or eliminate the duties members owe to each other.

6. Disadvantages

1. In order to enjoy some of the benefits of a LLC, the members must create a tailored operating agreement. A knowledgeable attorney should be retained to

E. Corporations

1. A corporation is a statutory entity. Corporations are governed by the Michigan Business Corporation Act, MCL 450.1101 *et seq.*
2. Corporations must file Articles of Incorporation with LARA. MCL 450.1202 *et seq.*
3. A “C” corporation is subject to double income taxation. It is taxed at the entity level, and then the shareholders are taxed on dividends.
4. An “S” corporation passes through income and losses *pro rata* based on ownership. S corporations are generally not taxed at the entity level. S corporation status requires:
  1. Election by all shareholders.
  2. The filing of form 2553 with the Internal Revenue Service.
  3. Only one class of stock.
  4. A maximum of 100 shareholders.
  5. Only certain individuals or entities may be shareholders. Shareholders may be individuals, certain trusts, and estates, and may not be partnerships, corporations, or non-resident aliens.
5. Directors and officers owe a fiduciary duty to the corporation. They must: (i) perform their duties in good faith, (ii) with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and (iii) in a manner he or she reasonably





believes to be in the best interests of the corporation. MCL 450.1541a(1). Shareholders generally do not owe a fiduciary duty to other shareholders (unless the duty is set forth in a shareholder agreement).

6. Advantages

1. Shareholders have limited liability for acts of the corporation.
2. Shareholders can generally freely transfer their stock (unless subject to a shareholder agreement stating otherwise).
3. S corporations receive pass through income tax treatment (no double taxation)
4. S corporations may lead to savings on self-employment taxes.

7. Disadvantages

1. C corporations are subject to double income taxation.
2. A C corporation cannot pass through its losses to its shareholders. IRC 172.
3. Unlike a LLC, S corporation allocations of income or loss are rigid.
4. The Michigan Business Corporation Act is more stringent than other applicable entity statutes in terms of requirements applicable to corporations.
5. Certain corporate activities require shareholder approval including, amending the Articles

of Incorporation (except under certain circumstances) (MCL 450.1611(3)), adopting a plan of merger or share exchange (MCL 450.1703a(1)), and selling all or substantially all of the corporation’s assets outside of the ordinary course (MCL 450.1753). Most changes require approval from the majority of shareholders and may require approval from an affected class of shareholders. Shareholder agreements may require approval from a greater percentage of shareholders for certain actions.

**VII. FORM OF DEED**

- A. The common deed in Michigan is the “warranty deed” where the seller warrants title. The “Special Warranty Deed” (sometimes called a “Covenant Deed”) is becoming more accepted and popular whereby the seller gives warranties against title defects arising during seller’s period of ownership only. Most title insurers do not see this type of *limited* warranty deed as an impediment to issuing title insurance. Quit claim deeds are also frequently used where the seller conveys whatever interest it has and provides no warranties of title, in which case the buyer should obtain and would be relying entirely on title insurance to address title defects.

**VIII. CLOSING COSTS/ADJUSTMENTS**

- A. Seller usually pays the transfer taxes due at the time of the conveyance. There is a standard county tax of \$0.55 per \$500 of consideration, however, a county with a population over 2 million



may charge as much as \$0.75 per \$500. The state transfer tax is \$3.50 per \$500 in consideration. There are several transfer tax exemptions mostly involving family or related party transactions with little consideration.

- B. Buyer and seller adjust for water, sewer, gas/oil, electricity, and taxes. Depending on what part of the state the property is located, proration of taxes varies by local custom. The most common methods for pro rating taxes are: (1) paid in advance, due date basis (favors seller), (2) calendar year and (3) paid in arrears, due date basis (favors buyer). With retail or multi-family commercial properties, closing adjustments also include, among others, rents, management/operating expenses and common area maintenance expenses.
- C. Certain lands used for agricultural purposes pay reduced taxes that, in some instances, may be clawed back if the agricultural use is terminated.
- D. Standard federal income tax withholding is required for sellers who cannot provide a non-foreign FIRPTA affidavit.

**IX. OTHER CLOSING DOCUMENTS**

- A. Residential Property – If the property is to be used as a principal residence, the seller should rescind any PRE, or “Personal Residence Exemption” seller may have (results in lower property taxes) and the buyer should promptly file a PRE form with the local assessing unit.
- B. If the property is leased (residential or commercial/industrial) and if the lease is to be terminated at or before closing, a lease termination instrument signed

by the tenant should be provided. If the lease(s) is to continue after the sale and purchase, an “assignment and assumption of lease(s)” instrument should be executed by the seller and buyer.

- C. Title insurance is always recommended and an effective review of title to the property is nearly impossible without a title commitment (and copies of all exceptions to the seller’s title that survive closing) being provided, which commitment is the basis for the title policy issued at closing. Typically, the seller pays the premium charged to issue the title insurance policy. Buyer is responsible for a title policy required for any purchase money financing.

**X. RECORDING REAL ESTATE DOCUMENTS**

Deeds and any other documents evidencing an encumbrance on title are recorded at the Register of Deeds for the County where the property is located.

**XI. PROPERTY TAXES**

- A. Real Estate Taxes
  - 1. Real property is assessed for taxes based on its true cash value that is to be determined annually by the local assessing unit. The assessed value is to represent 50% of the true cash / fair market value.
  - 2. Michigan has a “cap” on increases in a property’s taxable value that is tied to inflation. The taxable value stays low (no more than 5% increase annually) regardless of any increase in the fair market value of the property and is reset to equal assessed value anytime there is a non-exempt “transfer of



ownership.” A transfer includes (with a few exceptions) the sale of stock or membership/partnership interests (not a deed) in the entity having title to the property.

3. Only businesses pay personal property taxes, and they are structured the same way and subject to the same “cap” as real property. There are many exemptions and certain value thresholds that apply to personal property, depending on the value and/or the type of personal property involved.