Michigan's Bewildering Uncapping Rules and Trusts

Take-Away: Moving title to real property into or out of a trust can possibly trigger an uncapping of the real property's state equalized value if rules and definitions are not closely followed and small steps are not taken.

Background: When it comes to confusion, few laws (besides, or course, the Tax Code's generation skipping transfer tax rules) are worse than Michigan's real property tax uncapping rules when there is a 'transfer of ownership.' With the 'transfer of ownership' of real property, the property's taxable value for the calendar year following the year of transfer resets to the property's (almost always higher) state equalized value (SEV) for the calendar year that follows the transfer. [MCL 211.27a(3).] While that sounds pretty straightforward, by the time the Michigan Tax Commission (MTC) Transfer of Ownership Guidelines are factored into the 'transfer', one sometimes feels that he/she is living inside Alice in Wonderland when attempting to discern when a 'transfer' actually occurs and thus 'uncaps' a parcel's SEV. While the Guidelines do not have the force of law and are allegedly 'merely explanatory,' yet they tend to be treated as the gospel by tax assessors around the state, even when the Guidelines impose requirements that are not found within the language of the Michigan General Property Tax Act. [MCL 211.1 et. seq.]

Transfer of Ownership: The Act defines a 'transfer of ownership' as the conveyance of title to or a present interest in property, including the beneficial use of the property, the value of which is substantially equal to the value of the fee interest. [MCL 211.27a(6).] A beneficial use of the property is defined as the right to possession, use, and enjoyment of property, limited only by encumbrances, easements, and restrictions of record. [MCL 211.27a(11)(b).] The transactions (or 'transfers') that are covered by these definitions include deeds, land contracts, conveyances to a trust, *a trust distribution, a change in the sole present beneficiary of a trust,* distributions from a probate estate, leases, tenancy in common, and entity ownership changes. *Transfers* to and from trusts, or a change of a trust beneficiary are covered in the paragraphs that follow.

Trusts: If real property is conveyed *to* a trust, it is considered a *transfer of ownership,* and the transfer uncaps the property's taxable value. However, there are two exceptions to this general rule. [MCL 211.27a(6)(c).] If real property is distributed *from* a trust, that distribution constitutes a *transfer of ownership* and the taxable value of the real property is uncapped, again subject to two exceptions. [MCL 211.27a(6)(d).] If real property is held in the name of a trust and there is a change in the trust's sole present beneficiary(ies), there is a *transfer of ownership*' and the taxable value uncaps, again subject to the two statutory exceptions of MCL 211.27a(6)(e).] Accordingly, this means that it is important to fit into one of the following exceptions to avoid an uncapping of a parcel's SEV.

Transfers to Trust: The exceptions to a transfer to a trust are: (1) if the grantor of the real property is the settlor, the settlor's spouse, or both, and the sole present beneficiary(ies) of the trust is either the settlor, the settlor's spouse, or both. If that is the case, the transfer is not a *transfer of ownership,* and the taxable value does not uncap [MCL 211.27a(6)(c)(i) and MCL 211.27a(7)(g)(i); and (ii).] (2) beginning with conveyances on or after December 31, 2014, for Residential Real Property only, if the grantor of the real property is the settlor, the settlor's spouse, or both, and the sole present beneficiaries of the trust are a qualifying Family Members of the settlor or the settlor's spouse and the Residential Real Property is not used for any Commercial Purpose following the conveyance, then the transfer is not a *transfer of ownership* and the taxable value does not uncap. [MCL 211.27(6)(c)(ii) and 211.27a(g)(ii).]

Distribution from Trust: The exceptions to distributions of real property from a trust are: (1) if the distributee is the sole present beneficiary of the trust, the spouse of the sole present beneficiary of the trust, or both, then the distribution is not a *transfer of ownership* and the taxable value of the real property does not uncap [MCL 211.27a(6)(d)(i)]; and (2) beginning with conveyances on or after December 31, 2014, for Residential Real Property only, if the distributee is a qualifying Family Member of the settlor or the settlor's spouse and the Residential Real Property is not used for any Commercial Purpose following the conveyance, then the transfer is not a *transfer of ownership* and the taxable value does not uncap. [MCL 211.27a(6)(d)(ii) and 211.27a(7)(v).]

Change in Trust Beneficiary: A change in the sole present beneficiary(ies) of a trust is a *transfer of ownership*' unless: (1) the change merely adds or substitutes the spouse of the sole present beneficiary [MCL 211.27a(g)(i)] or (2) beginning on or after December 31, 2014, for Residential Real Property only, a change that adds or substitutes a qualifying Family Member of the settlor or the settlor's spouse and the Residential Real Property is not used for any Commercial Purpose. [MCL 211.27a(7)(g)(ii).]

***Family Member*:** This term of art is limited to mother, father, brother, sister, son, daughter, adopted son, adopted daughter, grandson, or granddaughter. [MRC 211.27a(6)©(d)(e)(f)(7)(d), (7)(g)(ii), (7)(u), (7)(v).] Note that this list currently does not include in-laws, or step-relatives, except where the specific provision applies to a spouse's qualifying Family Member. There is presently a bill floating around Lansing that would expand the definition of Family Member to include son-in-law and a daughter-in law. [It's an election year, so don't get your hopes too high.]

***Residential Real Property*:** This term of art is defined as 'real property classified as residential real property', which is not particularly helpful. [MCL 211.34c, 211.27(11)(h).] It includes platted or unplatted parcels with or without buildings, condominium apartments located within or outside a village or city which are used for, or probably will be used for, residential purposes, parcels that are used for, or probably will be used for recreational purposes, such as lake lots and hunting lands, located in an area used predominately for recreational purposes and a home, cottage, or cabin on leased land. Note that this definition is NOT limited to homestead real property. [Transfer Guidelines, at page 15.] Injecting the concept *probably will be used for* into the definition brings future intentions (of whom?) into the debate of whether real property is intended to be used for residential purposes..

Commercial Purposes: This term of art means real property that is used in connection with any business or other undertaking intended for profit and includes the rental of *Residential Real Property* for a period of 15 days or more in a calendar year. [MCL 211.27a(11)(c).]

Examples: How these definitions and exceptions play out in 'real world' estate planning situations are reflected by the following examples.

1. **Trust for Settlor's Children and their Spouses:** Dan transfers his small cottage on Pine Lake to a trust for his sole benefit during his lifetime. On Dan's death the trust continues for Dan's three children and their spouses, Veronica, Betty, and Archie. The trust continues for the lifetime of Dan's three children and their spouses until the last to die, at which time the trust terminates, and all of the trust assets are then distributed to Dan's then living grandchildren per capita.

There is no uncapping on Dan's transfer of the title to the cottage to the trust since he is the sole settlor and sole lifetime beneficiary. When Dan dies, the sole present beneficiaries of the trust change from Dan to his children and their spouses. Dan's children are qualified Family Members, but not his son-in-law and his daughters-in-law. Consequently, on Dan's death, the SEV of the Pine Lake cottage will be uncapped. HB 4014 would amend MCL 211.27a(7)(g)(ii), (u) and (v) to include grandparents and spouses of qualifying Family Members, e.g., Dan's son-in-law and his daughters-in-law, as a qualifying *Family Members*.

2. **Trust for Spouse's Children:** Wilma owns her home before she married Fred; Wilma inherited the home from her maiden aunt. Wilma and Fred continue to live in the home after their marriage. Fred has a daughter, Peg, from a prior marriage. Wilma has no children of her own, nor any heirs. Wilma transfers the title to the home to her revocable trust with the home. The trust provides that if Wilma dies before Fred, the trust will continue for Fred's sole benefit. If Fred dies before Wilma, the trust continues to hold the home for Wilma's sole benefit. On Wilma's following death the home is to be distributed to Peg, Fred's daughter, free from trust. Fred dies die before Wilma. After Wilma's subsequent death the trustee distributes the home to Peg. Fred's death is not an uncapping event, since Wilma who established the trust is the sole lifetime beneficiary of the trust. On Wilma's death, where the trust terminates and the home is distributed to Peg, Wilma's step-daughter, there is a genuine question if that distribution is an uncapping event. Arguably, the transfer of title from the trust to Peg is covered by MCL 211.27a(6)(d)(ii) because Peg is a Family Member of the settlor's spouse, Fred. However, it is not clear from the statute's terminology if that is the case: the statute's exception does not mention 'the qualified Family Member of one's deceased spouse." Is a 'late spouse' or a 'deceased spouse' considered the same as the transferor's 'spouse' under the statute? This is just one example of how the Act, and its 'twisty' definitions, can be interpreted in different ways, upon which an exception to the uncapping rules turns. An uncapping could be avoided if Wilma adopts Peg before Wilma's death.

3. **Trustee Rents the Cottage:** Fred and Ethel own a large cottage on Torch Lake. Fred and Ethel transfer title to their cottage to a trust for their lifetimes. On the death of both Fred and Ethel the cottage remains held in trust for the benefit of their three children. Fred dies. Because of the loss of Fred's pension on his death

and Ethel losing her Social Security benefits after Fred's death (his SSI benefits were larger,) Ethel is concerned about her cashflow to sustain the expensive cottage. Ethel decides to rent the Torch Lake cottage for 4 weeks each August to help defray the cottage's ongoing expenses. The transfer of the cottage to the trust by Fred and Ethel is not an uncapping event since Fred and Ethel are the sole present beneficiaries of the trust. [MCL 211.27a(6)(c)(i).] On Fred's death, that event, too, is not an uncapping event because Ethel was also a settlor of the trust and she remains as the sole present beneficiary of the trust. However, on Ethel's death when the three children substitute for her as the sole present beneficiaries of the trust, that substitution constitutes a *transfer of ownership*. Usually, a change in sole present beneficiaries of a trust is treated as an exception to the uncapping rules [MCL 211.27a(6)(e)(ii),] but because the trustee continued Ethel's routine renting out the cottage for four weeks in August, that rental causes the cottage to be considered as used for a Commercial Purpose [under MCL 211.27a(11)(c).] Accordingly, the change in beneficiaries (from Ethel to her three children) does not meet the statutory exception [MCL 211.27a(6)(e)(ii).] If the rental of the cottage had stopped after Ethel's death, the cottage's SEV would not have been uncapped.

4. **Cohabiting Couple:** Brad and Jennifer have each gone through several painful and public marriages and divorces. They decide to cohabit with no intention of ever remarrying again. Brad brings an expensive home on the beach in Harbor Springs to the marriage, which is Brad and Jennifer's principal residence. Brad transfers title to the Harbor Springs home to his trust. The trust provides that upon Brad's death the title to the Harbor Springs home is to be distributed to Jennifer, free from the trust. Brad dies. Brad's transfer of the title to the home to the trust was not a *transfer of ownership*, and the Harbor Springs home's taxable value remained uncapped. After Brad's death, when title to the Harbor Springs home is distributed to Jennifer free from trust, that is when the SEV is uncapped. Jennifer, while a long-time cohabitant of the home with Brad, is not treated as a qualifying *Family Member* of Brad, nor is she Brad's spouse. Jennifer argues with the local assessor that on Brad's death she was the sole present beneficiary of Brad's trust (she lived with Brad), and thus as the distributee from the trust she is exempt from any SEV uncapping [under MCL 211.27a(6)(d)(i).] The local assessor ignores Jennifer's argument and uncaps the SEV because of the change in sole present beneficiary on Brad's death. The assessor points to MCL 211.27a(7)(i). With hindsight, perhaps Brad should have added Jennifer as a joint

owner of the home, along with a cohabitation agreement that declared that despite their joint ownership of the home (JTWOS) , it was still to be treated as his separate property. Their joint ownership of the home would have exempted the home from uncapping its SEV. [MCL 211.27a(7)(i).]

5. **Ladybird Deed:** Erica, a widow, signs a ladybird deed that transfers title to herself for her lifetime, along with a retained lifetime general power of appointment to dispose of the real property and retain the entire sales proceeds. The contingent remainder interest is Erica's revocable trust which names Erica's children as the trust beneficiaries, in the even that Erica does not exercise her lifetime general power of appointment. A ladybird deed from Erica to herself with the contingent remainder interest to Erica's trust is not the equivalent of a deed. The ladybird deed to herself is not a *transfer of ownership since* Erica is the sole present beneficiary of the trust. [MCL 211.27a(a)(6)(c) and (7)(g).] The Act and Guidelines do not treat a ladybird deed as a *transfer of ownership.*[MCL 211.27a(7)(c).] The *transfer of ownership* takes place on the termination of Erica's life estate. The exemption from uncapping fails to exist on the expiration or termination of Erica's life estate. The trustee is not the transferor's qualifying *Family Member.*[MCL 211.27a(7)(d).] In short, Erica's 'trust,' which is the remainder beneficiary under her ladybird deed, is not a qualifying *Family Member* under the Act's definition. Note that HB 4014 would amend MCL 211.27a(7)(d) to add a trust for which the transferor or the transferor's spouse is the settlor and would become the sole present beneficiary as a qualifying *Family Member.*

6. **Joint Ownership:** This example follows the famous (or infamous, take your pick) *Kooster* decision. Dan purchases a cottage. The next year Dan conveys the cottage to himself and to his daughter Dawn as joint tenants with full rights of survivorship (JTWOS.) Dan then dies in the same year. Dawn, as the surviving joint owner, then adds her brother Ben as a joint tenant with full rights of survivorship to the cottage. Dan was the original owner. Dawn became a co-tenant with Dan. Because one of the joint tenants, i.e., Dan, was an *original* owner before the *initial* joint tenancy was created, the transfer to Dawn as JTWOS was exempt from uncapping. When Dan died, the *initial* JTWOS terminated. One of the joint tenants that was terminated was an *original* owner (Dan) before the JTWOS was terminated. Dan was an *initial* joint tenant. Dawn

continued as a joint tenant after Dan's death. Dan's death did not result in an uncapping of the cottage's SEV. But when Dawn added Ben as the *new* joint owner of the cottage with her, i.e., a successive JTWOS was created. The creation of that *second* JTWOS was a *transfer of ownership* that uncapped the cottage's SEV, because neither Dawn nor Ben was an *original* owner of the cottage. Probably, with hindsight, Dan should have added both Dawn and Ben as JTWOS when he created the *initial* JTWOS for the cottage.

7. **Family Cottage Entity:** TACO Properties, Inc. owns a family compound on Beaver Island. Don owns 24% of the shares. Don purchases 48% of the shares from two other shareholders, Eric, and Baron, in 2026. After that purchase, but still in 2026, Don sells 20% of the shares to his brother-in-law, Jared. Since more than 50% of the corporation's shareholder interests was transferred in TACO Properties, for purposes of uncapping there has been a *transfer of ownership,* and the taxable value of the family compound is uncapped. [MCL 211.27a(6)(h).] The *transfer of ownership* under the Guidelines is viewed cumulatively from the date of the last *transfer of ownership.* Because there were two separate *transfers of ownership* in 2026 which represented more than 50% of the corporation's ownership cumulatively, that resulted in a *transfer of ownership* that uncapped the compound's SEV.

Practical Observation: Due to all of the pitfalls that can be encountered when dealing with the Act and the goal of trying to meet the statutory exceptions, it is imperative that transfer transactions need to be structured by taking small steps to keep the real property's taxable value uncapped. Rather than the settlor directing that the successor trustee distributes real property from her trust to "my daughter and to her husband as tenants by the entirety," the trustee should be directed to convey the real property from the trust to the daughter alone, without any mention of her husband. The daughter can then convey title to the distributed real property to herself and to her husband and tenants by the entirety. By adding the additional 'step' (or deed from daughter to her husband) both steps will qualify for an exception to the *transfer of ownership* rules. Small steps, despite the temptation to take 'short cuts' in conveyance, can often keep the real property's taxable value uncapped.

Conclusion: The Michigan General Property Tax Act is needlessly complex. The Michigan Tax Commission's *Guidelines* adds yet another layer of complexity to the Act and its interpretation. While the Michigan Legislature periodically amends the Act in response to consumer complaints or court decisions, as one wit noted, all those amendments have accomplished is make the Act look like a piece of Swiss cheese, with more holes than substance. Perhaps someday in the future the Legislature will acknowledge that the *transfer of ownership* rules need to be simplified and reflect how most people want to transfer title to this homes and other real property on their deaths.

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