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The Michigan Tax Tribunal

An Overview for Municipal Officials and Practitioners

Table of Contents

The Michigan Tax Tribunal: An Overview for Municipal Officials and Practitioners

3 Introduction

3 Basic Principles

3 Definitions

4 General Process

- Assessment
- Board of Review
- Appeal to Tax Tribunal

5 The Tax Tribunal Process

- The Administrative Procedures Act of 1969
- The Tax Tribunal Act
- The General Property Tax Act

7 The Appraisal Process: The Tribunal Perspective

- True Cash Value
- Three Approaches to Value
 - Sales Comparison/Market Approach
 - Cost Approach
 - Income Approach

13 Key Cases for Municipal Practitioners in the Michigan Tax Tribunal

The Michigan Municipal League is proud to offer this manual for municipal officials and attorneys who practice in the Michigan Tax Tribunal. It is hoped that this manual will help provide practical and valuable insight on the Tribunal process. This manual is designed to provide an overview for officials whose municipalities are impacted by the decisions of the Tax Tribunal on a daily basis.

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- The Michigan Municipal League

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INTRODUCTION

It is important for municipal officials to be aware of and understand the property tax process as the amount of taxes that a municipality raises has a direct impact on the municipality's coffers and is crucial to the Municipality's budgetary process. Even more importantly, an understanding of the tax process by municipal officials helps enable municipal officials to ensure that property owners in their municipalities are being fairly and legally taxed. Proposal A is important because of the limitations it places on the amount of taxes that can be levied against a property in any given year and because of the declining economy, even upon an uncapping of properties' taxable values, assessed values are more likely to approximate taxable values.

BASIC PRINCIPLES

- Cities and townships share three constitutional powers: assessing property, collecting property taxes and conducting elections.
- The administration of the property tax system is a joint effort among municipalities, county government and the state.
- The Michigan Constitution requires the legislature to provide for the uniform general ad valorem taxation of real and tangible personal property not exempt by law and to provide for the determination of true cash value of the property and the proportion of true cash value at which such property shall be uniformly assessed which shall not exceed 50 percent. Mich Const 1963, art IX, sect 3. Uniformity is applicable to the method of assessments and the rate of taxation.
- The General Property Tax Act (MCL 211 et seq). outlines the requirements set forth in the Constitution.
- A strong, stable local tax base is essential for strong, stable local government. A local unit's tax base grows with each rise in property values (capped by the rate of inflation, more commonly called the CPI, for property that has not sold), new construction and the uncapping of sold

properties. In a declining market, accurately assessed values for a property that sells or on which there is new construction minimizes the loss to the local tax base.

- Enacted by the Michigan voters in 1978, the Headlee Amendment revised 11 sections of the Michigan Constitution of 1963, i.e., Article IX, Sections 24 - 34 and created tax limitations on the state, county, municipal, school districts. For local governments, the Headlee Amendment requires:
 - the state to reimburse local governments for mandated activities,
 - a rollback in local authorized millage rates in the event the total taxable value increases more than inflation, and
 - voter approval for any local tax not previously authorized.
- For example, Proposal A, adopted in 1994, resulted in amendments to the Michigan Constitution. The amendments include the limitation of annual assessment increases on property, excluding new construction, for taxes levied in 1995 and after to five percent or the rate of inflation, whichever is less, until the property is sold. Upon sale, the property is to be assessed at 50 percent of its true cash value.

DEFINITIONS

Assessed value—the proportion of *true cash value* which, after January 1, 1996, shall not exceed 50 percent. Mich Const 1963, art IX, sect 3.

State equalized value—term generally used to describe the *assessed value* of the property's true cash value.

True cash value—the value required by the Constitution and statute to be determined for property subject to taxation. Generally, *true cash value* means the price at which both the buyer and seller are willing to transact business in an open market. MCL 211.27. *True cash value* is the

additions are any property new to the assessment roll. Losses are any property that was formerly a part of the assessment roll but which is gone from the current assessment year.

Taxable value—the amount used to calculate the property tax bill. *Taxable value* is the lesser of the state equalized value or the capped value. Selling property uncaps its *taxable value*. Upon the sale of a property, the assessing officer must assess the property at 50 percent of the *true cash value*.

Tax day—the day on which the taxable status of persons and real and personal property is determined. Tax day for a given year is the December 31 of the immediately preceding year. MCL 211.2(2).

Exempt property—property which is not subject to taxation under the General Property Tax Act. See MCL 211.7- 211.7nn for real property exemptions and MCL 211.9-211.9k for personal property exemptions.

on an annual basis which includes an estimate of the true cash value and the assessed value of the property subject to taxation.

- Section 24c (MCL 211.24c) provides:

The assessor shall give to each owner or person or persons listed on the assessment roll of the property a notice by first-class mail of an increase in the tentative state equalized valuation or the tentative taxable value for the year. The notice shall also specify the time and place of the meeting of the board of review.

Most assessors, however, provide a Notice of Assessment to all property owners regardless of whether or not an increase has been made. It should be noted, however, that the statute only requires the notice be given for increases in valuation.

BOARD OF REVIEW

A board of review has two main tasks: 1) to review the tax roll and correct errors that were discovered after the assessment roll was approved and 2) to hear appeals from property owners regarding their assessments.

Generally, the board of review of a township or city is appointed by the governing body and consists of either 3, 6 or 9 electors of the unit of government, sitting in committees of three for purposes of hearing appeals. A city, however, may alter the composition, size and manner of appointment as prescribed by its charter. The board sits in March for valuation disputes and in July and December for other matters including poverty and other exemption cases, clerical error situations and other nonvaluation matters.

APPEAL TO TAX TRIBUNAL

For properties classified as residential, an appeal must be made first to the board of review before jurisdiction will attach to an appeal requesting a formal hearing at the Tax Tribunal. The jurisdiction of the Tribunal in an assessment dispute for property classified as residential is invoked by the filing of a written petition/appeal on or before July 31 of the year being appealed.

GENERAL PROCESS

ASSESSMENT

The General Property Tax Act provides the general framework for the assessment of property subject to taxation.

- Section 2 of the General Property Tax Act (MCL 211.2) requires that the taxable status of persons and real and personal property shall be determined as of each December 31 of the immediately preceding year.
- Section 10 (MCL 211.10) requires that an assessment of all property liable to taxation shall be made annually in all townships, villages and cities by the applicable assessing officer.
- Section 24 (MCL 211.24) outlines the required information to be included in the assessment roll. The assessing officer of each township, village and city is required to prepare an assessment roll

TIP: Practitioners representing municipalities in the Tax Tribunal should review the filing date of the appeal. Jurisdiction does not attach unless the appeal has been timely filed.

THE TAX TRIBUNAL PROCESS

Litigating an *ad valorem* property tax appeal in the Michigan Tax Tribunal requires a basic understanding of three sets of laws:

- Administrative Procedures Act of 1969 (MCL 24.201 et seq.)
- Tax Tribunal Act (MCL 205.701 et seq.)
- General Property Tax Act (MCL 211.1 et seq.)

In addition, practitioners should be aware of applicable local charters and ordinances establishing procedural requirements which may impact appeals to the Tribunal.

TIP: Before appearing before the Tax Tribunal, a practitioner should thoroughly review the applicable statutes, charter and ordinances.

THE ADMINISTRATIVE PROCEDURES ACT OF 1969

At the outset, the Tax Tribunal is at times described as a “quasi-judicial” court. The Tax Tribunal is not a court within the state’s judiciary, i.e., the One Court of Justice. Rather, the Tribunal falls under the Michigan Administrative Hearing System within the Department of Licensing and Regulatory Affairs by virtue of Executive Order 2011-4, an agency of the executive branch of state government. As such, the Administrative Procedures Act (APA) provides the structural underpinning for activities within the executive branch of government, generally, and the Tribunal, specifically.

The APA addresses two categories of activities: hearings and rule making. Within the hearings category, the APA identifies informal and formal hearings. A meeting with the board of review in a residential valuation case can be classified as an informal hearing. The hearings at the Tribunal are classified as formal hearings. As is with all administrative law cases,

a litigant must “exhaust its administrative remedies” before proceeding to the next step for a successful appeal.

TIP: If a property owner is appealing the value of residential property and did not appear before the local Board of Review, the Tribunal lacks jurisdiction under MCL 205.735a, and the Tribunal may not consider the petition other than to dismiss the case. See *Electronic Data Systems Corp v Flint Twp*, 253 Mich App 538, 544 (2002).

The APA does not provide an exhaustive set of rules for the conduct of a formal hearing. It does set forth some general caveats regarding evidence and procedure including the rule that the Michigan Rules of Evidence do not strictly apply and that the record for a hearing can be kept open to receive additional evidence.

TIP: A practitioner presenting evidence at the Tribunal should approach a Tax Tribunal case as if it is analogous to a case in the state’s circuit or district court.

The second category of activity addressed in the APA is the *rule making* function. Generally, rule making allows an agency to adopt rules of process and substantive matter. The rule adoption process must comport with Fifth Amendment due process requirements relative to notice and public hearings. In the case of the Tribunal, rules pertaining to a MTT hearing have been adopted and can be found at http://www.michigan.gov/documents/dleg/MTT_Proposed_Rules_2009_297930_7.pdf. The specific authority as opposed to the general rules found in the APA for adopting the rules is found in the Tax Tribunal Act, MCL 205.701 et seq. It should be noted that where a specific tribunal rule does not exist, the Michigan General Court Rules and APA govern. TTR 111. (4).

THE TAX TRIBUNAL ACT

The Tax Tribunal Act provides the enabling authority for the creation of the Tribunal. The Act provides that the Tribunal shall consist of seven members, a CPA member, an assessor, an appraiser, two attorneys and two at-large members, one of which may be an attorney. Additionally, the Act provides for two magistrates and a clerk. In current practice, the members and the magistrates (administrative law judges) as well as hearing officers conduct the tribunal hearings.

The Tribunal is divided into two divisions: a division referred to as the “entire tribunal” and a “small claims” division. Historically

the small claims division is associated with residential properties although smaller non-residential properties are included where the amount in controversy is low. A case before the “entire tribunal” does not mean that the entire tribunal hears the case; rather it means that the case involves property for which the amount in controversy is larger in amount.

Relative to the exhaustion of remedies requirement, MCL 205.735a(3) of the Tax Tribunal Act provides that:

(3) Except as otherwise provided in this section or by law, for an assessment dispute as to the valuation or exemption of property, the assessment must be protested before the board of review before the tribunal acquires jurisdiction of the dispute under subsection (6).

An exception to the general rule is found at MCL 205.735a(4)(a) which states that for “commercial real property, industrial real property, or developmental real property, the assessment may be protested before the board of review or appealed directly to the tribunal without protest before the board of review as provided in subsection (6).”

With respect to the timing of the appeal to the Tribunal, again, a distinction has been made between commercial/industrial and residential properties. MCL 205.735a(6) states that:

(6) The jurisdiction of the tribunal in an assessment dispute as to property classified under section 34c of the general property tax act, 1893 PA 206, MCL 211.34c, as commercial real property, industrial real property, developmental real property, commercial personal property, industrial personal property, or utility personal property is invoked by a party in interest, as petitioner, filing a written petition on or before May 31 of the tax year involved. The jurisdiction of the tribunal in an assessment dispute as to property classified under section 34c of the general property tax act, 1893 PA 206, MCL 211.34c, as agricultural real property, residential real property, timber-cutover real property, or agricultural personal property is invoked by a party in interest, as petitioner, filing a written petition on or before July 31 of the tax year involved.

Jurisdiction of the Tribunal in all other matters is invoked by a party in interest, as petitioner, filing a written petition within 35 days after the final decision, ruling, or determination.” MCL 205.735a(6).

THE GENERAL PROPERTY TAX ACT

In order to understand the scope of the General Property Tax Act, it is important to know its constitutional origins. Mich Const 1963, art IX, sect 3 states in part:

The legislature shall provide for the uniform general ad valorem taxation of real and tangible personal property not exempt by law except for taxes levied for school operating purposes. The legislature shall provide for the determination of true cash value of such property; the proportion of true cash value at which such property shall be uniformly assessed, which shall not, after January 1, 1966, exceed 50 percent; and for a system of equalization of assessments.

This language divides cases into taxation (valuation) cases in which true cash value is determined and cases in which the issue is whether or not property is exempt from taxation.

Valuation Cases

MCL 211.1 codifies this language stating “[t]hat all property, real and personal, within the jurisdiction of this state, not expressly exempted, shall be subject to taxation.”

Relative to valuation cases, MCL 211.27(1) states “[a]s used in this act, ‘true cash value’ means the usual selling price at the place where the property to which the term is applied is at the time of assessment, being the price that could be obtained for the property at private sale, and not at auction sale except as otherwise provided in this section, or at forced sale.”

Since true cash value need be determined in a valuation case, the Tribunal rules provide that in entire tribunal cases “[a] party’s valuation disclosure in a property tax appeal shall be filed with the tribunal and exchanged with the opposing party as provided by order of the tribunal.” TTR 252. (1). A valuation disclosure is defined as “documentary evidence or other tangible evidence in a property tax appeal which a party relies upon in support of the party’s contention as to the true cash value of the subject property or any portion thereof and which contains

the party's value conclusions and data, valuation methodology, analysis, or reasoning. See also TTR 205.1252 and TTR 205.1283." TTR 101(1)(m). Valuation evidence is also required in small claims cases, although since the typical small claims petitioner is unrepresented the evidence is less sophisticated.

Exemption Cases

Exemption cases are heard in both the entire tribunal and small claims divisions. Generally, they fall into categories involving the use of the property such as charitable uses, or instances where poverty impacts the ability to pay taxes or special exceptions such as homestead exemption. While these types of case do not require valuation disclosures, evidence is required and, as is the case in all the types of tribunal cases, the petitioner has the burden of proving a value or an exemption.

TIP: The municipal attorney should meet with the municipal assessor on a monthly basis to review the docket of pending Tax Tribunal cases. The monthly review provides:

- a dual docketing system
- a review of pending cases and "work up" of value, if necessary, and
- an opportunity to strategize discovery.

THE APPRAISAL PROCESS: THE TRIBUNAL PERSPECTIVE

The Tribunal defines a valuation disclosure to be "documentary evidence or other tangible evidence in a property tax appeal which a party relies upon in support of the party's contention as to the true cash value of the subject property or any portion thereof and which contains the party's value conclusions and data, valuation methodology, analysis, or reasoning." TTR 101(m).

An appraisal valuing the property as of the relevant tax dates is considered to be the most reliable form of a valuation disclosure. The Tribunal, however, will admit other forms of relevant evidence of the fair market value of the property under appeal, even if that evidence is not determinative on the issue. Profes-

sional Plaza, LLC v City of Detroit, 250 Mich App 473, 476 (2002).

The appraisal should identify the appraisal problem, including elements that acknowledge the client, identify the intended use and users of the appraisal, establish the purpose of the appraisal assignment, describe the effective date of the appraisal, determine the scope of appraisal, and indentify and describe any extraordinary assumptions or hypothetical conditions that may alter the valuation of the property. These items form the necessary framework that is vital to the valuation of the subject property.

Inherent in valuing the subject property is a determination with respect to the highest and best use of the subject property. The highest and best use of property is "the reasonably probable and legal use of vacant land, or improved land, that is physically possible, appropriately supported, financially feasible, and that results in the highest value." *The Dictionary of Real Estate Appraisal*, Appraisal Institute, 5th ed, p93.

Finally, discussion of the location of the subject property along with its market characteristics is key to valuing the property. As detailed below, data from the subject's market area provides numerous integral pieces in all three approaches to value.

TRUE CASH VALUE

The Michigan Tax Tribunal is charged with determining a property's true cash value as part of its review of the lawfulness of the property assessment. See MCL 205.737(1) and *Alhi Development Co v Orion Twp*, 110 Mich App 764, 767 (1981). The Michigan Legislature defines true cash value to be "the usual selling price which could be obtained at a private sale, not a forced or auction sale, at a place where the property is at the time of assessment." MCL 211.27. The usual selling price can include "sales at public auction held by a nongovernmental agency or person if those sales have become a common method of acquisition in the jurisdiction for the class of property being valued." *Id.* The usual selling price can also include sales at public auction held by a non-governmental agency/individual when such sales are a common method of acquisition.

The usual selling price, however, does not include:

- a sale at public auction if the sale is part of a liquidation of the seller's assets in a bankruptcy proceeding.

- a sale where the seller is unable to use common marketing techniques to obtain the usual selling price for the property.
- a sale or other disposition by the state of Michigan or an agency/political subdivision of state of Michigan of land acquired for delinquent taxes or an appraisal made in connection with the sale or other disposition or the value attributed to the property of regulated public utilities by a governmental regulatory agency for rate-making purposes is not controlling evidence of true cash value for assessment purposes.

Sales, appraisals, or other different dispositions of state lands acquired for delinquent taxes by the state, its agencies or subdivision cannot be considered controlling proof of true cash value.

True cash value must consider factors including location, zoning, existing use, value influencers, and present economic income of structures on the property. True cash value is synonymous with fair market value. *CAF Investment Co v State Tax Comm*, 392 Mich 442, 450 (1974). The purchase price, however, is not presumptive of value. MCL 211.27(5).

THREE APPROACHES TO VALUE

Generally, there are three commonly accepted methods of valuation when determining the true cash value of property:

- 1) the sales comparison/market approach,
- 2) the cost less depreciation approach, and
- 3) the income approach.

Meadowlanes Limited Dividend Housing Ass'n v City of Holland, 437 Mich 473, 484-485 (1991); *Antisdale v City of Galesburg*, 420 Mich 265, 276-277, n1 (1984). Michigan courts generally require consideration of all three approaches when determining value. Michigan courts have also provided guidance regarding the appropriate valuation method or principle applicable to a number of specific types of property. See discussion of key cases below.

TIP: All three commonly-accepted methods of valuation should be included within the appraisal (valuation disclosure) and offered as evidence at a Tax Tribunal hearing.

Sales Comparison/Market Approach

The sales comparison/market approach is based on the premise that the market determines a price for the property being valued in the same manner that it determines the prices of comparable/competitive properties. This process involves estimating market value by comparing the subject property with other similar properties that have sold, are listed or have pending offers.

Michigan appellate courts have recognized that the sales comparison market approach is the only valuation method that directly reflects the balance of supply and demand for property in marketplace trading. *Antisdale v City of Galesburg*, 420 Mich 265, 276 n1 (1984). The sales comparison market approach is reliable when property being valued is typically bought and sold regularly.

The sales comparison/market approach offers the most precise valuation when comparables selected are the most recently closed sales, located in a subject's immediate area, with similar physical and economical attributes. Circumstances generally require expanding outside the immediate jurisdictional boundaries to find sales that are deemed comparable. Adjustments are made to account for differences in characteristics of the subject property and comparables.

FOUR-STEP SALES COMPARISON/MARKET APPROACH PROCESS

Step 1: Research Sales

The first step involves researching and reviewing sales, listings, and pending transactions (i.e., offers to purchase) for properties similar to the property being valued. These comparable properties should be located within the same competitive market as the subject property. In selecting comparables, it is imperative to identify the various characteristics of each comparable including property type, use, location, physical conditions, property rights conveyed, financing terms, motivations of the buyers/sellers, and dates of transactions. Reliable sources for obtaining data each sale or listing include:

- public records
- commercially available data
- published articles
- interviews with market participants

TIP: Commercial real estate databases such as CoStar and Loopnet provide up-to-date commercial real estate listings and sales information for properties throughout the State of Michigan.

Step 2: Verification

The second step of the sales comparison/market approach method is to verify that the sales were the result of arm's-length transactions under typical market conditions. The information can be substantiated through consultation with those involved in the transactions, including:

- principal brokers
- closing agents
- lenders

Step 3: Comparing Comparables with Subject Property and Adjustments

Each comparable must then be evaluated in terms of its similarity to the subject property. Relevant units of comparison to be considered, include:

- property rights involved in the transaction
- financing terms
- conditions of sale
- market conditions
- location
- physical characteristics (e.g., building size, year built, land size, frontage/access, land-to-building ratio, building condition)
- economic characteristics (e.g., expense ratio, leases, management, tenants).

Units of comparison will vary depending on the type of property being valued.

To account for the differences between the subject property and comparable property, adjustments are made to the ultimate sale price. These adjustments can be quantitative adjustments (dollar or percentage) or qualitative adjustments (e.g. superior, inferior).

Step 4: Reconciliation

Finally, after making any and all adjustments based on similarities and differences between the comparable and the subject property, the values are reconciled into a single value or range of values.

Cost Approach

The cost approach is based on the principle of substitution. The assumption is that a buyer would not pay any more for a property than it would cost to acquire the same/similar land and construct the same improvements. The approach examines separately the property's land and its improvements. The cost approach is typically relied on in valuing new improvements, property for which there is a lack of market activity that limits adequate sales comparables, property that is not income producing, or specialty properties.

- Determine *replacement vs. reproduction cost*.

Reproduction cost is the estimated cost to construct the exact same building and improvements as of the effective valuation date. In doing so, the same materials are used.

Replacement cost is the estimated cost to construct a substitute building, using contemporary buildings standards.

- The land value for a particular property is determined by applying the sales comparison/market approach to vacant land sales or listings in a market competitive with that of the subject property.
- Additionally, the cost to construct a replacement for the existing structure and improvements less accrued depreciation is determined. The resulting figure, plus the value of the land, provides a value indication through the application of the cost approach.

- Building cost estimators, including Marshall & Swift, provide the relevant cost calculation data.
- The cost approach is problematic in accurately measuring and estimating depreciation, functional obsolescence, and external obsolescence.
- The cost approach can require numerous subjective adjustments to reach a property's fair market value.

Income Approach

Under the income approach, a property's ability to generate future returns is expressed in terms of present value. In Michigan, generally accepted appraisal practice (GAAP) favors the application of the income approach for income-producing property. *Northwood Apartments v City of Royal Oak*, 98 Mich App 721 (1980); *Eversdyk v City of Wyoming*, 10 MTT 664 (1999), MTT Docket No. 195925. The present value of the subjects dependent upon the projected income stream and the capitalization rate used.

TIP: In valuing income-producing property, the income approach has been deemed the most appropriate by the Tribunal and Michigan appellate courts.

The two most commonly accepted methods under the income approach are direct capitalization and discounted cash flow (DCF).

DIRECT CAPITALIZATION

Direct Capitalization is the method used to convert a single year's income expectancy into an indication of value. In projecting the value of the property, the direct capitalization method relies on estimating income based on market rent information for negotiated leases or current rental offerings within the marketplace with a deduction for expenses (both historic and market based) and then capitalized or discounted at a rate of return required by investment capital.

- Within the income approach, the direct capitalization method has been deemed the most useful in evaluating the true cash value of income-producing property. *First City Corp v Lansing*, 153 Mich App 106, 116 (1986).

- Procedurally, the direct capitalization method requires four steps:

- 1) an estimation of the annual gross income that the subject property is capable of producing;
 - 2) a deduction of the amount of necessary annual operating expenses;
 - 3) the selection of a capitalization technique/rate; and, finally,
 - 4) capitalization of the net income into value.
- A more in-depth discussion of the direct capitalization process is outlined below.

- The direct capitalization method can be expressed by the formula:

$$\text{True Cash Value} = \frac{\text{Net Operating Income}}{\text{Overall Capitalization Rate}}$$

- The direct capitalization method is most reliable when the subject property is operating on a stabilized basis.

Direct Capitalization Process

Step 1: Estimating Gross Income

The first step in valuing a property using the direct capitalization method is to determine the amount of income the property produces. The total potential income for the property is defined as Potential Gross Income (PGI).

- *Market Rent* (also referred to as the economic rent) is the term applied to the most probable rent that the property would command in an open market.
 - Market data will provide the range of market rents for the subject property.
 - Market rent can be quantified as either asking rents or rents paid for comparable properties.
- *Contract rent* is the actual rent based on a lease. Contract rent can be higher, lower, or equal to market rent.

- *Effective rent* is the “total of the base rent, or minimum rent stipulated in a lease, over the specified lease term minus rent concessions--e.g., free rent, excessive tenant improvements, moving allowances, lease buyouts, cash allowances, and other leasing incentives.”

Appraisal of Real Estate, Appraisal Institute, 13th ed, 2008, p454. Effective rent can be based on contract rents for leases in place or leases at market rates.

In valuing income producing properties for *ad valorem* tax purposes, the Tribunal and the Michigan Legislature require that *present economic income* be used. MCL 211.27(4).

- *Present economic income* is the ordinary, general, and usual economic return realized from the lease or rental of property that was negotiated under current, contemporary conditions between parties equally knowledgeable and familiar with real estate values.
- The actual income generated by the lease or rental of property is not the controlling indicator of its true cash value.

By statute, there are some limited instances in which present economic income is not considered:

- Property is subject to a lease entered into prior to January 1, 1984 and the terms of the lease governing the rental rate or tax liability have not been renegotiated after December 31, 1983.
- Nonprofit, housing cooperative is subject to regulatory agreements between the state or federal government entered into before January 1, 1984 if the owner is
 - a nonprofit cooperative housing corporation,
 - engaged in providing housing services to its stockholders and members, and
 - does not pay dividends or interest upon stock or membership investment but that does distribute all earnings to its stockholders or members.

The PGI is then adjusted to account for vacancy and collection loss after calculating the total potential the property could generate. This deduction is necessary to account for rent concessions offered by the landlord, vacancies, non-payment of rent or other charges, and the loss as a result of tenant turnover. The end result is the effective gross income for the subject property.

Step 2: Deducting Annual Operating Expenses from Income

In valuing the property for *ad valorem* tax appeal purposes, it is only necessary to deduct those expenses incurred to maintain and operate the real property. These annual operating expenses can be separated into two categories: fixed and variable. Variable expenses include management fees for operation of the property, utilities, repair and maintenance expenses, payroll expenses, and replacement allows/reserves.

Certain expenses, including debt obligations (mortgage interest and payments), income taxes, real estate taxes, capital improvements, and depreciation should not be deducted from income calculations.

Real estate taxes are not included as an expense because the historical amount of taxes incurred by the property owner is based on the value of the property on the assessment rolls. However, in filing a tax appeal, the property owner is challenging the assessment and the commensurate tax charges. The appropriate amount of tax cannot be calculated until the value of the property is first determined. Using historic real estate taxes would alter the actual value of the property. To account for real estate taxes, the effective tax rate is added to the cap rate.

Net Operating Income (NOI) is the effective gross income less operating expenses. Note that debt service and depreciation are *not* included. Net operating income is capitalized to develop the present value of the subject property.

Step 3: Capitalization Rate

The capitalization rate represents the relationship between a property's income and its value. It is intended to reflect the risk of ownership and expected life of the improvements. The overall cap rate reflects the return on the investment.

Additionally, in property tax appeals, the overall cap rate will reflect the effective tax rate for the subject property. The effective tax rate is equal to the actual tax rate multiplied by the assessment ratio.

In derivation of the cap rate, the Comparable Sales Method and the Band of Investment Method are the most common ways in which appraisers develop capitalization rates. In addition, the Effective Gross Income Multiplier is also an accepted alternative to generating cap rates.

Comparable Sales Method

Deriving a cap rate through use of comparable sales is generally the preferred method. However, this process requires data on sales price, income and expense data for the property, financing terms, and market conditions at the time of sale. The comparable sales method is most applicable when there are numerous sales of property similar and competitive with property being valued.

The overall rate can be estimated by dividing each property's net operating income (NOI) by its sale price.

Band of Investment Method

The band of investment method is a technique in which capitalization rates "attributable to components of a capital investment are weighted and combined to derive a weighted-average rate attributable to the total investment." *Appraisal of Real Estate*, Appraisal Institute, 13th ed, 2008, p505. Essentially, the band of investment method blends the weighted rates of mortgage and equity into an overall capitalization rate. In other words, the band of investment method is meant to consider the interest rates available in the marketplace.

Effective Gross Income Multipliers

Finally, the Effective Gross Income Multiplier (EGIM) provides an alternative when some of the information necessary for deriving a cap rate through the use of the Comparable Sales Method was not easily accessible. The EGIM is particularly useful where reliable gross income and sales price data are available. Effective Gross Income Multiplier (EGIM) is used in conjunction with Net Income Ratio (NIR) to establish a capitalization rate. The EGIM process can best be summarized through the applicable formula Cap Rate = NIR/EGIM.

In this equation, the EGIM is calculated as the ratio of the property's sale price to its effective gross income (sale price / effective gross income). Conversely, the Net Income Ratio (NIR) is the ratio of net operating income to effective gross income.

- Net Income Ratio = 1- Operating Expense Ratio (OER)

- Operating Expense Ratio (OER) is the ratio of operating expenses to effective gross income; the property's operating expense divided by its gross operating income

Step 4: Capitalization

Once the subject property's net operating income has been calculated and the capitalization rate selected, the final step is to apply the capitalization rate to the net operating income as described in the formula above. In other words, the net operating income will be divided by the capitalization rate. This final value will often be rounded to reflect the lack of precision in valuing a particular parcel of property.

DISCOUNTED CASH FLOW (DCF)

The discounted cash flow method, also known as yield capitalization, is used to convert future benefits, typically a periodic income stream and reversion, into present value by discounting each future benefit at an appropriate yield rate or by applying an overall rate. See *Dictionary of Real Estate Appraisal*, Appraisal Institute, 5th ed, 2010, p211. The reversion or resale is a lump sum benefit an investor receives upon termination of an investment or at the immediate analysis period. *JC Penney Co, Inc v City of Ann Arbor*, 15 MTT 534, 541 (2008). The discounted cash flow method is a reflection of the property's future financial performance based on current market expectations.

Similar to the direct capitalization method, the discounted cash flow method involves four steps:

1. establishing a projection period;
2. calculating cash flow and reversion;
3. deriving the appropriate yield rate; and,
4. discounting to present value

Yield capitalization is the more complex of the income approach methods. Computer technology and models are generally used to perform DCF calculations.

For a more in-depth discussion of DCF methodology and its application to property tax appeals, see the Tribunal's decision in *Palace Sports & Entertainment, Inc v City of Auburn Hills*, 17 MTT 220 (2009).

KEY CASES FOR MUNICIPAL PRACTITIONERS IN THE MICHIGAN TAX TRIBUNAL

The Michigan Tax Tribunal over the last several years has issued opinions in hundreds of cases, all of which are relevant to a Michigan municipal attorney practicing before the Michigan Tax Tribunal. The reported opinions of the Michigan Tax Tribunal can be found in the Michigan Tax Tribunal Reporter.

There are several landmark cases, however, that have been decided by either the Michigan Supreme Court and/or Michigan Court of Appeals that every Michigan municipal attorney practicing before the Michigan Tax Tribunal should be familiar with.

TIP: A practitioner should be familiar with the facts and decisions underlying the following seminal Tax Tribunal cases and their holdings.

This section addresses the following five key cases:

1. *Meadowlanes Limited Dividend Housing Association v City of Holland*, 437 Mich 473 (1991)
2. *Dixon Road Group v City of Novi*, 426 Mich 390 (1986)
3. *WPW Acquisition Co v City of Troy*, 466 Mich 117 (2002)
4. *Wexford Medical Group v City of Cadillac*, 474 Mich 192 (2006)
5. *Toll Northville Limited and Biltmore Wineman, L.L.C. v Northville Township*, 460 Mich 6 (2008)

Meadowlanes Limited Dividend Housing Association v City of Holland, 437 Mich 473 (1991)

This case involves a dispute over the assessed value of the Meadowlanes Limited Dividend Housing Association's federally subsidized, low income housing complex located in the city of Holland, Michigan. Specifically, the Michigan Supreme Court held that it was proper for the Michigan Tax Tribunal to take into account the value of a federal government mortgage subsidy in valuing the subject property. However, the real significance of

this case is that it addresses in great detail the parameters and appropriate appraisal methods to be utilized in valuing properties in the State of Michigan.

The Michigan Supreme Court held that appellate review of Michigan Tax Tribunal decisions is limited and, when fraud is not alleged, appellate courts are required to determine whether the Tribunal made an error of law or adopted a wrong principle. The Michigan Supreme Court went on to hold that the definition of "cash value" (true cash value) as contained in MCL 211.27(1) is the usual selling price at the place where the property in which the term applied is at the time of assessment and that the Michigan Legislature in its definition of "cash value" had listed a variety of factors to be considered in the valuation determination. The Michigan Supreme Court noted that the Legislature, in its definition of "cash value," did not direct that specific methods of valuation be utilized in valuing certain properties and that the task of approving or disapproving specific valuation methods has fallen to the courts.

The Michigan Supreme Court held in the *Meadowlanes* case that there are three traditional methods of determining true cash values of properties in the state of Michigan and that, when possible, all three methods of valuation should be used. Specifically, the Michigan Supreme Court held in its opinion in the *Meadowlanes* case:

There are three traditional methods of determining true cash value, or fair-market value, which have been found acceptable and reliable by the Tax Tribunal and the courts. They are: (1) the cost-less-depreciation approach, (2) the sales-comparison or market approach, and (3) the capitalization-of-income approach. Variations of these approaches and entirely new methods may be useful if found to be accurate and reasonably related to the fair-market value of the subject property. *Antisdale*, *supra* 420 Mich at 277, n.1, 362 NW2d 632. It is the Tax Tribunal's duty to determine which approaches are useful in providing the most accurate valuation under the individual circumstances of each case. *Antisdale*, *supra* at 277, 362 NW2d 632. Regardless of the valuation approach employed, the final value determination must represent the usual price for which the subject property would sell. *Safran Printing*, *supra* 88 Mich App at 380, 276 NW2d 602.

Under each approach, the appraiser analyzes data mathematically to determine an estimate of the fair-market value of both the physical real estate and all the interests, benefits, and rights inherent in ownership of that real property. All three approaches should be used whenever possible, and an appraisal which disregards an approach by mere statements and without research justifying nonuse is considered incomplete. The values derived under the various approaches are correlated, reconciled, and weighed in order to reach a final estimate of value. The ultimate goal of the valuation process is a well-supported conclusion that reflects the study of all factors that influence the market value of the subject property.

Furthermore, the Michigan Supreme Court held that tax shelter benefits and mortgage interest subsidies, while intangibles, are also value-influencing factors that should be reflected in the assessment process to the extent that they increase or decrease the value of a parcel of property. In that regard, the Michigan Supreme Court held in its opinion in the *Meadowlanes* case:

Similarly, although the mortgage-interest subsidy is an intangible, and not taxable in and of itself, it is a value-influencing factor. In *Antisdale, supra* at 284, . . . we recognized that without the subsidy these types of properties would not exist. Therefore, the value of the subsidy, if any, should be reflected in the assessment process. We agree with the *Meadowlanes I* Court's conclusion:

Just as tax benefits affect the selling price of federally subsidized property, so does the existence of an interest subsidy attached to a mortgage being assumed by the purchaser.
Id. 156 Mich App at 250.

As clarified above, the subsidy is not taxed in and of itself. It is merely an intangible value influencer to be considered in the valuation and assessment process in the same manner as tax benefits, location, zoning, and other intangible value influences.

As a result, when practicing before the Michigan Tax Tribunal, it is important to ensure that the appraisal being utilized to

support the municipality's values of a subject property complies with the valuation method requirements set forth by the Michigan Supreme Court in the *Meadowlanes* case.

TIP: Make sure that the appraisal method being used to support value of the subject property complies with valuation method requirements set forth in *Meadowlanes*.

Dixon Road Group v City of Novi, 426 Mich 390 (1986)

This case involved the Dixon Road Group's and Novi Twelve Associates' appeals of special assessments levied against their properties for road improvements, water main improvements, and storm sewer improvements. The Petitioners argued that the special assessments against their properties were invalid because the cost of the improvements exceeded the increase in value of the property and that there was no special benefit conferred upon their properties beyond that to the community as a whole.

The Michigan Supreme Court in the *Dixon Road Group* case held that municipal decisions regarding special assessments are presumed to be valid and that special assessments against properties should be upheld by the courts unless there is a substantial or unreasonable disproportionality between the amount assessed and the value which accrues to the land as a result of the improvements made. Specifically, the Michigan Supreme Court held:

We believe that a determination of the increased market value of a piece of property after the improvement is necessary in order to determine whether or not the benefits derived from the special assessment are proportional to the cost incurred.

* * *

While we certainly do not believe that we should require a rigid dollar-for-dollar balance between the amount of the special assessment and the amount of the benefit, a failure by this Court to require a reasonable relationship between the two would be akin to the taking of property without due process of law. Such a result would defy reason and justice. Therefore, we conclude that while decisions made by municipalities with

special assessments will be reviewed by the Michigan Tax Tribunal and appellate courts, that being whether there is a substantial or unreasonable disproportionality between the amount assessed and the value which accrues to the land as a result of the improvements.

In addition, the Michigan Supreme Court's opinion contemplates that in order to make a determination as to whether there is a substantial or unreasonable disproportionality between the special assessment amount and the value which accrues to the property as a result of the improvements, it is necessary to do a pre-improvement appraisal and a post-improvement appraisal of the property involved. The Michigan Supreme Court also held that it is not necessary for there to be a rigid dollar-for-dollar balance between the amount of the special assessment and the amount of the benefit (increased value) to the property involved.

TIP: If a petitioner is challenging a special assessment in a case before the Michigan Tax Tribunal and fails to file a pre-improvement appraisal and post-improvement appraisal of the subject property, the municipal attorney should at the conclusion of the petitioner's proofs make a Motion For A Directed Verdict (known as a Motion For Involuntary Dismissal in the Michigan Tax Tribunal) on the grounds that the petitioner has not met its enhanced burden of proof and has not overcome the presumption that the special assessment is valid.

WPW Acquisition Co v City of Troy, 466 Mich 117 (2002)

This case involves the Michigan Supreme Court addressing the validity of certain post-Proposal A *additions*. Specifically, in 1994, the voters in the State of Michigan approved an amendment to the Michigan Constitution known as Proposal A, which amendment added language to Article IX Section 3 of the Michigan Constitution and provided for the creation of taxable values of property and also provided that the taxable value of each parcel of property adjusted for additions and losses shall not increase each year by more than the increase in the general price level (consumer price index) or five percent, whichever is less.

Proposal A also provided that if there were additions, the taxable value of property could be adjusted in excess of the consumer price index/five percent cap on value. After Proposal

A was adopted, the Michigan Legislature enacted amendments to MCL 211.34d, which amendments expanded the definition of additions and added several new additions. Prior to Proposal A, MCL 211.34d defined *additions* to mean:

All increases in value caused by new construction or a physical addition of equipment or furnishings, and the value of property that was exempt from taxes or not included on the assessment unit's immediately preceding year's assessment role.

After the adoption of Proposal A, an amendment to MCL 211.34d was made to include an addition that provided for an increase in taxable value caused by an increase of occupancy of the property if the value attributable to the occupancy rate had been previously allowed as a loss due to a decrease in occupancy. In 1991, before the ratification of Proposal A, WPW Acquisition Company, which was the owner of a rental property in the city of Troy, was granted by the city a decrease in the assessed value of its property due to occupancy. In 1996, after the passage of Proposal A, the city of Troy increased the taxable value of WPW's property by 13% due to an increase in occupancy. WPW protested the increase of its property's taxable value as being violative of the Proposal A constitutional amendment to Article IX, Section 3, that limited annual increases in a property's taxable value to the lesser of five percent or the increase in general price level for the immediately preceding year.

The Michigan Supreme Court in its opinion in the *WPW Acquisition Co.* case held that the post-Proposal A amendment to MCL 211.34d that provided for new and/or additional additions that were inconsistent with the pre-Proposal A definition of additions, were unconstitutional. Specifically, the Michigan Supreme Court held:

Troy relied on this statutory provision in increasing WPW's taxable value for the office building at issue by over thirteen percent in 1996 on the ground that this was based on an increase in occupancy covered by the statute and, thus, on an "addition" that was not subject to the general limit on annual property tax increases imposed by section 3.

However, we agree with WPW that MCL 211.34d(1)(b)(vii) is unconstitutional in purporting to define "additions" for purposes of § 3 in a way that is inconsistent with the established meaning

of that term at the time that it was added to this constitutional provision by the passage of Proposal A. This is because “if a constitutional phrase is a technical legal term or a phrase of art in the law, the phrase will be given the meaning that those sophisticated in the law understood at the time of enactment unless it is clear from the constitutional language that some other meaning was intended.” *Michigan Coalition of State Employee Unions v Civil Service Comm*, 465 Mich 212, 223; 634 NW2d 692 (2001). At the time that Proposal A was submitted to the voters, the General Property Tax Act established “additions” as a technical legal term in the area of property taxation. As we discussed above, that statutory definition of “additions” simply did not encompass any increase in the value of property due to increased occupancy by tenants.

It is important for municipal attorneys when faced with a dispute that involves a taxable value increase greater than five percent or the consumer price index, whichever is less, to verify that the addition being relied on to increase the subject property’s taxable value is an addition that would be allowable pursuant to the Michigan Supreme Court’s decision in the *WPW Acquisition Co.* case.

TIP: It is important to make sure that if your municipality’s assessor has increased a property’s taxable value by more than Proposal A limits based on an addition that the addition in question is one that has not been ruled to be invalid by the Michigan Supreme Court’s decision in the WPW case.

***Wexford Medical Group v City of Cadillac,* 474 Mich 192 (2006)**

The petitioner, Wexford Medical Group, is a nonprofit corporation that provided healthcare in Wexford County, Michigan, which is a federally designated health professional shortage area. The Wexford Medical Group did business as Great Lakes Family Care and was a 501(c)(3) nonprofit organization owned by Trinity Health Care and Munson Health Care, two other 501(c)(3) organizations. Wexford Medical Group had a charity care policy and open access policy for Medicare and Medicaid patients which provided free and discounted healthcare to anyone whose income was up to twice the federal poverty level,

with Wexford treating patients on a first come-first serve basis, with no limit on the number of Medicare and Medicaid patients it could treat.

Wexford Medical Group claimed that it was exempt from *ad valorem* real and personal property taxes because it was a “charitable institution” under MCL 211.7o and MCL 211.9(a) and also because it served a public health purpose as described in MCL 211.7r. The city of Cadillac rejected Wexford’s claim that it should be exempt from *ad valorem* real and personal property taxes and both the Michigan Tax Tribunal and the Michigan Court of Appeals affirmed the city’s assessments of Wexford’s property, both finding that Wexford did not qualify for a charitable institution tax exemption.

The Michigan Supreme Court reversed the decision of the court of appeals and held that Wexford was a charitable institution because not only was it organized as a charitable institution as reflected in its statement of purpose in its bylaws, but it devoted itself to charitable works on the whole and that it was organized chiefly, if not solely, for charity. More importantly, the Michigan Supreme Court in its opinion in the *Wexford* case set forth the factors that must be considered in determining whether an entity is a charitable institution under MCL 211.7o and MCL 211.9(a) when it provided:

In light of this definition, certain factors come into play when determining whether an institution is a “charitable institution” under MCL 211.7o and MCL 211.9(a). Among them are the following:

- (1) A “charitable institution” must be a nonprofit institution.
- (2) A “charitable institution” is one that is organized chiefly, if not solely, for charity.
- (3) A “charitable institution” does not offer its charity on a discriminatory basis by choosing who, among the group it purports to serve, deserves the services. Rather, a “charitable institution” serves any person who needs the particular type of charity being offered.
- (4) A “charitable institution” brings people’s minds or hearts under the influence of education or religion; relieves people’s bodies from disease, suffering, or constraint; assists people to establish themselves for life; erects or maintains public

buildings or works; or otherwise lessens the burdens of government.

(5) A “charitable institution” can charge for its services as long as the charges are not more than what is needed for its successful maintenance.

(6) A “charitable institution” need not meet any monetary threshold of charity to merit the charitable institution exemption; rather, if the overall nature of the institution is charitable, it is a “charitable institution” regardless of how much money it devotes to charitable activities in a particular year.

The Michigan Supreme Court’s decision in the *Wexford* case is important as it set forth the standards that must be considered when determining whether a parcel of property will be exempt from ad valorem real and personal property taxes under MCL 211.7o and MCL 211.9(a).

TIP: In determining whether a property is entitled to an exemption from property taxes as a charitable institution pursuant to MCL 211.7o, it is crucial that an analysis of the six factors set forth in the Michigan Supreme Court’s opinion in the *Wexford* case be performed.

Toll Northville Limited and Biltmore Wine-man, L.L.C. v Northville Township, 460 Mich 6 (2008)

The Michigan Supreme Court in the *Toll Northville Ltd et al v Township of Northville* case held that the statute allowing municipalities to add to taxable value for the installation of public utility service in a public right of way was unconstitutional, but the Court also held that it was permissible to include in the value of a home at the time it is built or sold the value added as a result of access to utility service.

In Michigan, property taxes are based upon a property’s taxable value. Generally speaking, taxable value may not be increased beyond the property’s assessed value, and on an annual basis the taxable value may not be increased by more than the rate of inflation or five percent, whichever is less, unless there is a transfer of ownership of the property, or an addition to the property. In these situations, and respectively, the taxable value may be increased to one half the property’s market value

(the assessed value), or by one half the value of the addition to the property. The statute at issue in the *Toll Northville* case, MCL 211.34d(1)(b)(viii), is the statute specifically allowing for an addition to taxable value for the installation of public utility services, e.g. a water line being extended down a street so that a property may have access to municipal water.

The plaintiffs, who were residential property developers, had installed infrastructure into a subdivision as required by the municipality in order to obtain final plat approval. The municipality then increased the taxable value of the lots in the subdivision by the value attributable to the existence of the infrastructure in the right of way. The plaintiffs appealed the taxable value increase to the Michigan Tax Tribunal, and then had the Tax Tribunal proceedings held in abeyance while a constitutional challenge to MCL 211.34d(1)(b)(viii) was brought in Oakland County Circuit Court.

The court of appeals, upheld the circuit court’s finding that MCL 211.34d(1)(b)(viii) was unconstitutional, and that taxing the individual properties based upon the availability of public services and taxing utility lines as personal property to the utility companies was double taxation. The Supreme Court affirmed the finding that MCL 211.34d(1)(b)(viii) was unconstitutional because it was inconsistent with the meaning of additions used in Article IX, Section 3 of the Michigan Constitution and that public service improvements consisting of public infrastructure located on utility easements or lands that ultimately become public do not constitute additions to property within the meaning of that constitutional provision. The Michigan Supreme Court vacated the portion of the court of appeals’ opinion pertaining to double taxation.

The Supreme Court reasoned that the installation of public service improvements on public property or in utility easements was not a physical addition to the lot itself, and that the court of appeals was correct in upholding the circuit court’s opinion that the term “additions” as found in the State of Michigan Constitution referred to improvements that became part of the real property, such as fixtures or structures, and did not refer to public service improvements in the right of way.

In reversing the part of the court of appeals decision as it pertained to double taxation, the Supreme Court wrote:

. . . the value of physical lines, i.e., wires, pipes, etc., as tangible personal property is distinguishable from the market value added by the availability of utility services. The distinction

is important because value added from access to services is taxable to the extent that such services increase market value. Although installation of a public utility line may not be taxed as an addition in a case such as this, the value of such services will be incorporated into the value of each individual home at the time it is built or sold. *Opinion of the Supreme Court*, footnote 2.

While the Michigan Supreme Court determined that MCL 211.34d(1)(b)(viii) was unconstitutional, the opinion was silent with regard to whether its ruling was retroactive. On remand, the Tribunal was left to determine whether the Supreme Court's holding should be applied retroactively or prospectively in the tax appeal with the same name, *Toll Northville LP and Biltmore Wineman, LLC v Township of Northville*, MTT Docket No. 284952. The Tribunal held that retroactive application of the Supreme Court's invalidation of MCL 211.34d(1)(b)(viii) is inappropriate and adverse to established case law. As a result, the Supreme Court's ruling should only be applied prospectively.

In addition, the Tribunal addressed the issue of its jurisdiction regarding the calculation of taxable value in the tax years under appeal. The Tribunal in *Toll* held that the public service improvements were not added in the first year under appeal, yet determined that it had the authority to review the propriety of public service improvements added in a prior year. Thus, the Tribunal held that it was not limited in its calculation of taxable value pursuant to MCL 211.27a to using the finalized taxable value of the subject property in the immediately preceding tax year. Instead, the Tribunal calculated the taxable value at issue based on the removal of those public service improvements added to taxable value in a prior year not under appeal and carried forward the result using the capped value formula. This decision is currently pending review by the Michigan Court of Appeals.

It should be noted that the Tribunal's decision in *Toll* runs contrary to a recent decision by the Michigan Court of Appeals. In *JH Campbell, Inc v Township of Dexter*, unpublished opinion per curiam of the Court of Appeals, issued March 8, 2011 (Docket No. 295455). The Court of Appeals addressed the Tribunal's jurisdiction to review the calculation of taxable value in a year not under appeal and concluded that the "Tax Tribunal did not have jurisdiction to make changes to the 2007 and 2008 taxable values when those changes were initially reflected in 2004 and time for filing a timely appeal with the Tax Tribunal based

on the 2004 taxable values had long passed." The Court of Appeals relied on its decisions in *Leahy v Orion Township*, 269 Mich App 527, 528 (2006) and *Springhill Assoc Ltd Partnership #2 v Shelby Township*, unpublished opinion per curiam of the Court of Appeals, issued December 11, 2003 (Docket No. 247100).

TIP: Be aware of how your assessor has addressed public utilities and other infrastructure and whether they have been treated as an addition to taxable value.

