County Tax Reimbursement to Local Units – *Rafaeli* Case

Introduction

In July 2020, the Michigan Supreme Court in *Rafaeli, LLC v Oakland County* held that the retention of excess tax foreclosure proceeds by county treasurers from tax auctions constitutes "an unconstitutional taking without just compensation" in violation of the Michigan Constitution.

The case involved two property owners whose properties were foreclosed for unpaid property taxes and sold at auction for amounts in excess of the taxes and other charges due. One owner had unpaid property tax of $8.41 which grew to $285.81 with interest, penalties and fees, and the property was sold at auction for $24,500, resulting in excess proceeds of $24,200 or roughly 85 times the amount due. The other party owed roughly $6,000 and his property was sold at auction for $82,000, resulting in excess proceeds of over twelve times the amount due.

Pursuant to the General Property Tax Act (GPTA), the "foreclosing governmental unit," which is either the county in which a property is located or the state of Michigan, has the responsibility for the collection of the preceding year's unpaid property taxes. After one year the properties are considered "forfeited" but each property owner retains the right to redeem the property until a judgment of foreclosure is entered on the following March 31.

After that foreclosure judgment is entered, title is vested in the foreclosing governmental unit, and most properties are then sold at public auctions. The proceeds are used to reimburse a delinquent tax revolving fund which funds the local municipalities for the unpaid taxes and to cover other expenses of the foreclosure process, and the county or state retains the excess funds. Because auction proceeds are often insufficient to cover the taxes and fees, the properties sold for a price in excess of the taxes and fees in effect subsidize the costs for the entire tax foreclosure process.

The *Rafaeli* court found that the provisions of the GPTA conflicted with the Michigan Constitution's Takings Clause, and that the remedy for a government taking is just compensation for the value of the property taken. The court found that the property "taken" was the proceeds from the tax foreclosure sales which exceeded the actual amount of taxes, interest, penalties and fees owed. Therefore, the taxpayers were entitled to those excess proceeds as just compensation.

Amendments to the General Property Tax Act

In December 2020, the Legislature amended the GPTA to conform to the court's holding in *Rafaeli*. The amendments provide a process by which a person with some type of asserted equity interest in a property (a "claimant") declares that interest and ultimately may recover some portion of excess proceeds. The amendments are detailed, and the claim/recovery process is complex, however highlights of the applicable amended GPTA provisions include the following:

• Provide that the fee that the foreclosing governmental unit charges for each forfeited property must be used by the county treasurer for administration of activities under the statute, including but not limited to costs associated with providing required notices and with forfeiture, foreclosure, sale maintenance repair and remediation of property.

• Require that the certificate of forfeiture filed with the county register of deeds contain an explanation of the right of a person with an interest in the property at the time foreclosure becomes effective to claim an interest in excess proceeds after the sale at auction.

• Require that the notice of show-cause hearing provided to an owner or individual with an interest in foreclosed property, the published notice of foreclosure and the notice of foreclosure physically placed at a taxforeclosed property include phone and website information for legal resources to assist the owner or a person with an interest in the property in avoiding loss of their property interest, and contain an explanation of the right of a person with an interest in the property at the time foreclosure becomes effective to claim an interest in excess proceeds after the sale at auction.

• Impose a two-year limitation on actions brought to challenge the extinguishment of rights or the interest in post-sale excess proceeds.

• Require that a claimant must submit a notice of intention to claim an interest in post-sale proceeds and later file a motion to claim proceeds.

• Require that the foreclosing governmental unit send a notice to each claimant who submitted a notice of intent to claim an interest. That notice must contain information about the property, the sale, the potential excess proceeds and other individuals claiming an interest in the property. It must also advise the claimant that they must file a motion to claim excess proceeds.

• Require that the court hold a hearing for each property for which a claimant has filed a motion to recover excess proceeds. The court must determine the relative priority and value of each claimant's interest. The foreclosing governmental unit must pay amounts ordered by court within twenty-one days.

• Most notably for cities and villages, the amendments provide that if the state elects not to exercise its right of first refusal and no claimant has filed a claim for excess proceeds, the local unit (or, under certain circumstances, a city [i.e., Detroit] or county land bank) may purchase for the minimum bid. If, on the other hand the state elects not to exercise its right of first refusal and a claimant has filed a claim, the local unit seeking to purchase the property must pay the greater of the minimum bid or the fair market value of the property.

Implications of *Rafaeli* for Local Units

The *Rafaeli* decision and GPTA amendments are significant because they impact many of the thousands of foreclosure sales which occur each year in Michigan's 83 counties. Counties and the state are now required to issue payments to property owners whose properties were previously foreclosed and sold at auction for an amount in excess of the taxes due.

While counties are the governmental units most obviously affected by *Rafaeli* and the GPTA amendments there are also significant implications for local units such as cities and villages. *Rafaeli* introduced uncertainty about the implications of a local unit's purchase of foreclosed property within its boundaries prior to public auction for the minimum bid amount, which is equal to the taxes, interest, penalties and fees actually owed and unit later sells the property at a gain. The GPTA previously provided that upon sale, the local unit may retain funds up to the amount of "the minimum bid and all costs incurred relating to demolition, renovation, improvements, or infrastructure development." Any excess was transferred to the county's "delinquent tax property sales proceeds account" for the year in which the property was purchased by the local unit. The GPTA amendments removed those provisions.

Rafaeli cast doubt on local units' ability to retain amounts exceeding the minimum bid, even for actual costs incurred as part of land management and economic development strategies. The GPTA amendments address this uncertainty by requiring a local unit to pay the greater of the minimum bid or fair market value for any property for which a claim for excess proceeds has been filed, while preserving the ability to pay the minimum bid amount for a property for which no such claim has been filed. This requirement should prevent local units from ending up in a position whereby a surplus is later generated by a local unit selling such property at a gain and that gain is claimed as a taking. Essentially, only properties for which no claim has been made will have the potential of producing a gain over fair market value (excluding gains from simple increases in value over time, which would not be subject to the taking analysis).

In addition, the *Rafaeli* case has the potential to disrupt the delinquent tax revolving fund system in Michigan, and therefore the practice of county tax reimbursement to local units. This has implications for the many local units for whom county tax reimbursement is a critical cash flow and budget factor. While the GPTA amendments provide uniform procedures for claiming and adjudicating interests in excess sale proceeds, it codifies limitations on how counties and local units must spend sale proceeds and continues to signal budgetary impacts that will only become clear with time.

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