

LOTL TAX PRORATIONS

Hello Michigan Realtors® and welcome back to the Letter of the Law. In this installment, we are going to review considerations for Realtors® and their clients related to Tax Proration. This is yet another area where an informed Realtor® can show tremendous value.

As Michigan Realtors are aware, there are a number of different methods used to prorate real property taxes in this State. There is no correct method, and the customary method varies depending on where you are in the State. There are even places within the State where the customary proration methods for the July bill and the December bill are different.

When a buyer and a seller agree on a proration method, they are agreeing on whether to assume that tax payments cover services previously provided, services to be provided in the future, or services provided during the current fiscal or calendar year.

Some Realtors believe that tax proration methods are dictated by the taxing authorities involved. This is incorrect. As between the seller and the buyer, the choice of a tax proration method is purely a matter of negotiation. While not required, parties typically agree to prorate taxes according to the custom in the area. If the same method is used in each subsequent sale of a home, so the argument goes, each homeowner will have paid their “fair share” of the property taxes.

The basic tax proration methods are as follows:

1. The calendar year method where summer and winter taxes are treated as covering the calendar year in which they are billed on July 1st and December 1st.
2. The due date in advance method, where taxes are deemed to cover the 12-month -period **beginning** with the date they are billed.
3. The due date in arrears method, where taxes are deemed to cover the 12 month- period **ending** with the date they are billed, and
4. The fiscal year method in which taxes are deemed to cover services provided during the fiscal year in which they are levied. This is the most

complicated form of tax proration because portions of the tax bill must be separately prorated based on the fiscal years of the various taxing authorities (such as the county, municipality and school district).

There is a Michigan statute that dictates the proration method to be used in the event a purchase agreement is silent. While the statutory language is not as clear as it could be, it is generally agreed that the statute calls for a due date in advance proration.

As will be shown by the following hypothetical, the selection of the tax proration method makes a significant financial difference. To simplify the discussion, we will focus only on the proration of the July tax bill.

Assume the seller has already paid the July 1, 2025 tax bill in the amount of \$6000 and that the closing on the sale of the home occurs on September 1, 2025.

If this tax bill is deemed to be paid on a due date basis in arrears, then the July 1, 2025, bill will be deemed to cover the period between July 1, 2024 and June 30, 2025. When the **buyer** pays the next July tax bill, that tax bill will be deemed to cover the period between July 1, 2025 and June 30, 2026. Since the seller owned the home for two of those months (July and August of 2025), at closing, the **seller** would owe the **buyer** \$1000.

If this tax bill is deemed to be paid on a due date basis in advance, then the July 1, 2025, tax bill will be deemed to cover the period between July 1, 2025 and June 30, 2026. Since the buyer will own the home for 10 of those months (September 1, 2025 through June 30, 2026), at closing, the **buyer** will owe the **seller** \$5000.

If this tax bill is deemed to be paid on a calendar year basis, then the July 1, 2025 tax bill will be deemed to cover the period between January 1, 2025, and December 31, 2025. Since the buyer will own the home for 4 of those months (September 1, 2025 through December 31, 2025), at closing the **buyer** will owe the **seller** \$2000.

Whenever a Realtor® is working in an unfamiliar geographic area of the state (or using an unfamiliar purchase agreement form), they should pay particular attention to the tax proration provision. Again, there is no requirement that real property taxes be prorated according to the custom in the area, but buyers and sellers who agree otherwise should do so knowingly. Of course, if someone offers to prorate taxes in a way that is more advantageous to your client than the customary method in the area, it is in your client's interest to accept such an offer. As Realtors are aware, when comparing competing offers, there are a number of considerations in addition to the stated price, such as seller concessions, occupancy terms and inspection contingencies. It is important to remember that the proposed tax proration method is also one of those considerations. As the above example shows, the financial swing can be significant.

Thank you so much for watching! This topic usually generates a significant amount of discussion. So if you have any questions, please don't hesitate to reach out at the email in the video description. Thanks again, and we'll see you next time!