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## **MEMORANDUM**

TO: ELEVENTH ANNUAL REAL ESTATE SYMPOSIUM ATTENDEES

RE: DOCUMENTING PRORATIONING REAL ESTATE TAX

DATE: May 4, 2004

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The methods of proration for real estate taxes differ from community to community in Michigan. There are four methods principally used by Michigan municipalities to prorate taxes.

- 1) In the "calendar year method", summer and winter taxes are deemed to cover the year in which they are billed. For example, assuming a closing date of December 16, 2003, the seller is liable for taxes from January 1, 2003 through December 15, 2003 while the purchaser is responsible for taxes from December 16, 2003 through December 31, 2003.
- 2) In the "due date in advance method", the tax period covered by the municipal tax bill is for the following twelve-month period. Accordingly, if a closing occurs on December 16, 2003, and a community issues a summer tax bill which is due on July 1st and a winter tax bill which is due on December 1<sup>st</sup>, then the seller must pay that portion of the summer tax bill allocated to July 1, 2003 to December 15, 2003 and that portion of the winter tax bill allocated to December 1, 2003 to December 15, 2003 while the purchaser must pay that portion of the summer tax bill from December 16, 2003 to June 30, 2003 and that portion of the winter tax bill from December 16, 2003 to November 30, 2004.

- 3) In the "due date in arrears method", the tax period covered by the municipal tax bills is for the preceding twelve month period. Assuming the same facts set forth in the paragraph above, at the closing the seller must pay for that portion of the summer tax bill issued in 2004 for the period between July 1, 2003 and December 15, 2003 and that portion of the winter tax bill issued in 2004 for the period between December 1, 2003 and December 15, 2003.
- 4) The "fiscal year method" is calculated in the same manner as the "calendar year method", but taxes are deemed to cover the services provided for the fiscal year in which they are levied. This method is complex because different taxing authorities within a community have different fiscal years. Thus, separate prorations must be performed for each taxing authority each summer and winter.

Because no single method of proration exists in Michigan, the legislature has adopted a default procedure in the event parties are unable to agree. MCL 211.2(4) declares:

In a real estate transaction between private parties in the absence of an agreement to the contrary, the seller is responsible for that portion of the annual taxes levied during the 12 months immediately preceding, but not including, the day title passes, from the levy date or dates to, but not only including, the day title passes and the buyer is responsible for the remainder of the annual taxes. As used in this subsection, "levy date," means the day on which a general property tax becomes due and payable.

In *Chicago Title Insurance Company v. East Arm, L.L.C.*, Case number 01-093518, the Ingham County Circuit Court addressed, in an unpublished opinion dated November 25, 2003, the issue of what constitutes a sufficient agreement between parties to prevent the application of the default statutory method of proration. In that particular case, the purchase agreement required the proration of taxes but no method was specified. So, the title agent preparing the settlement sheets for the closing was advised by the municipality to employ the "due date in arrears method". Based on this information, the title agent prepared tax proration sheets signed by the seller and purchaser which sheets contained the following statements:

We, the undersigned buyers and sellers of the above-captioned property, hereby agree that the prorated taxes charged to the seller/buyer and credited to the seller/buyer at closing are \$\_\_\_\_\_...We agree that the above calculations are satisfactory and we hold THE TITLE OFFICE, INC, and EMPIRE NATIONAL BANK harmless from any loss or damage resulting from a variance in the tax figures once the actual tax bills are received.

After closing the title company discovered an error in the calculations and reimbursed seller for overpaid taxes. As seller's subrogee, the title company commenced action to recover the money from the purchaser. The title company argued that because no

agreement to the contrary existed between the parties, the statutory default method of proration should have been used. The purchaser maintained that the statutory default method did not apply because the executed tax proration sheets constituted an agreement to the contrary. Therefore, the purchaser contended that no adjustment to the taxes should be made. The Court agreed with the purchaser:

The statute does not preclude an “agreement to the contrary” as simply being an agreement for one party to the transaction to pay the other party a fixed amount in consideration of tax liability...[T]here is no basis for rejecting the purported agreement [namely the tax proration sheets] because it was signed separately from the purchase agreement or because the proration method established a fixed number rather than explicitly identifying one of the recognized methods of tax proration.

The Court found that the language in the tax proration sheets clearly reflected that the parties agreed to a method of proration and therefore the default method did not apply.

This unpublished opinion has some important ramifications for the real estate audience. Drafters of purchase agreements may want to specify the method of proration in order to achieve their objective. Title companies, on the other hand, may wish to add the language supplementing tax proration sheets. Title companies should add language providing indemnification rights to recover money for unpaid or overpaid taxes.

If you would like any additional information regarding the proration of taxes, please contact me at (248) 359-7501 or at [kxb@maddinhauser.com](mailto:kxb@maddinhauser.com).