County Tax Reimbursement to Local Units – Rafaeli Case

Introduction

On July 17, 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, 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 General Property Tax Act 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.

Implications of Rafaeli for Local Units

The implications of this decision are significant because it impacts many of the thousands of foreclosure sales which occur each year in Michigan’s 83 counties. Counties and the state may now be 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. Because the General Property Tax Act does not provide a mechanism for such repayments, the Michigan legislature may address the procedures which govern such payments, including whether taxpayers are required to take affirmative steps to obtain those payments, how prior ownership will be proven, payment to lienholders, and how those payments will be administered.

It is also noteworthy that while there is a six-year statute of limitations on takings claims, various individual lawsuits and class action suits have been filed that date back several years. Those lawsuits are in the early stages, but they seek to invoke the Rafaeli decision to open up a path for refunds of prior-year county auction surpluses (in the case of class actions, on a large scale), which could affect prior delinquent tax revolving fund activity, chargebacks and other tax collection and reimbursement activities that affect local units. It is unclear how potential refunds of past surpluses would be processed.

While counties are the governmental units most obviously affected by Rafaeli, the case also has significant implications for local units such as cities and villages. For example, the General Property Tax Act provides a local unit with the right to
purchase foreclosed property within its boundaries prior to public auction. The local unit can purchase the property for the minimum bid amount, which is equal to the taxes, interest, penalties and fees actually owed, and therefore would generate no surplus that could be the subject to a taking under Rafaeli. However, the local unit may later sell the property at a gain. The General Property Tax Act currently provides 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 is transferred to the county’s “delinquent tax property sales proceeds account” for the year in which the property was purchased by the local unit.

Presumably, the amount to be returned to the county delinquent tax property sales proceeds account under the statute would now be owed back to the property owner under Rafaeli, but what about the costs of any demolition, renovation, improvements, and infrastructure development? Those activities are discretionary on the part of the local unit and are often carried out as a part of larger land management and economic development strategies. Rafaeli may cast doubt on local units’ ability to retain of any amounts exceeding the minimum bid, even for actual costs incurred as part of an economic development strategy.

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.

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