

Senate Fiscal Agency  
P. O. Box 30036  
Lansing, Michigan 48909-7536

**SFA**



**BILL ANALYSIS**

Telephone: (517) 373-5383  
Fax: (517) 373-1986  
TDD: (517) 373-0543

Senate Bills 709 and 1246 (as enrolled)  
Sponsor: Senator Mike Goschka (S.B. 709)  
Senator George A. McManus (S.B. 1246)  
Senate Committee: Finance (S.B. 709)  
Farming, Agribusiness and Food Systems (S.B. 1246)  
House Committee: Agriculture and Resource Management

**PUBLIC ACTS 260 & 261 of 2000**

Date Completed: 9-13-00

### **RATIONALE**

Much has been said in recent years about how agriculture has come under increasing economic pressures. To address this and other related issues, the Senate Agriculture Preservation Task Force was created in the spring of 1999. The task force was asked to examine the condition of agriculture in Michigan and identify the challenges and threats it faces. After receiving testimony from over 250 persons, the task force produced a report on agriculture in the State. The report states that the farm sector is in the worst condition it has been in since the mid-1980s; prices for many commodities are as low as they have been in decades; few young people are entering agriculture; and economic pressures on farmers and processing industries are causing agricultural resources, including land, to be removed from farm production. The report concludes that the fundamental cause of these problems is low profits, and that policies designed to address the issues facing agriculture should focus on profitability. The report lists 12 specific recommendations for State action, including reducing taxes, developing new tax credits and enhancing current credits, and protecting farms against certain State and local regulations. In regard to tax reduction, the report recommends that the assessment cap on agricultural property be maintained when agricultural property is transferred.

Currently, under Article 9, Section 3 of the State Constitution, annual assessment increases on each parcel of property (adjusted for additions and losses) are limited to the lesser of 5% or the rate of inflation. When property is subsequently transferred (as defined by law), the assessed value reverts to 50% of true cash value (the State equalized valuation). As a result of the cap, each parcel has two values: the taxable value, which reflects the parcel's capped value and is the basis upon which taxes are levied; and the State equalized valuation (SEV), which is a measure of the value of the property on the open

market. Thus, in an area where the value of property rises faster than the rate of inflation or 5% per year, a parcel's taxable value will be lower than its SEV, and this discrepancy will grow larger each year. When the property is transferred, the new owner must pay taxes based upon the property's SEV.

It has been pointed out that this increase in property taxes can be particularly burdensome to those purchasing farm property, because such sales usually involve substantial tracts of valuable land. It has been suggested that, under certain circumstances, the assessment on transferred agricultural property should remain capped if the new owner keeps the property in agricultural use. In addition, since capping the assessment on transferred agricultural property will benefit the new owner, it has been suggested that the benefit should be recaptured if the property is converted to another use.

### **CONTENT**

**Senate Bill 709 amended the General Property Tax Act to specify that a transfer of ownership of property does not include a transfer of qualified agricultural property under certain conditions. (This means that annual assessment increases will remain limited to the lesser of 5% or the rate of inflation and the assessed value will not revert to 50% of true cash value upon the transfer.) Property that ceases to be qualified agricultural property after it is transferred will be subject to a recapture tax. Senate Bill 1246 created the "Agricultural Property Recapture Act" to impose a recapture tax on transferred agricultural property that is converted by a change in use so that it is no longer qualified agricultural property; and to require that revenue from the recapture tax be deposited in the Agricultural Preservation**

**Fund.** The bills were tie-barred.

**Senate Bill 1246**

**Senate Bill 709**

The bill provides that a transfer of ownership of property does not include a transfer of "qualified agricultural property", if the person to whom the property is transferred files an affidavit with the assessor of the local tax collecting unit and with the register of deeds for the county in which the property is located, attesting that the property will remain qualified agricultural property. The affidavit must be in a form prescribed by the Department of Treasury. An owner of qualified agricultural property must inform a prospective buyer of the property that it is subject to the recapture tax, provided in the Agricultural Property Recapture Act, if the qualified agricultural property is "converted by a change in use" (as defined in that Act). If property ceases to be qualified agricultural property at any time after being transferred, it is subject to the recapture tax, and the taxable value of the property, as of December 31 in the year it ceases to be qualified agricultural property, will be the property's State equalized valuation.

The bill provides that if the owner of qualified agricultural property files an affidavit attesting that the property will remain qualified agricultural property, and the property was qualified agricultural property for taxes levied in 1999 and each year thereafter, then the local tax collecting unit must revise the taxable value of the property to the taxable value that the property would have had if there had been no transfer of ownership of the property, and there had been no adjustment of the property's SEV, since December 31, 1999. If the taxable value of qualified agricultural property is adjusted according to these provisions, the property's owner is not entitled to a refund for any property taxes that were collected on the property before the adjustment was made.

(Under the General Property Tax Act, "qualified agricultural property" is unoccupied property and related buildings classified as agricultural, or other unoccupied property and related buildings located on that property devoted primarily to agricultural use. Related buildings include a residence occupied by a person who is employed in or actively involved in the agricultural use and who has not claimed a homestead exemption on other property. Property used for commercial storage, commercial processing, commercial distribution, commercial marketing, or commercial shipping operations or other commercial or industrial purposes is not qualified agricultural property. A parcel of property is devoted primarily to agricultural use only if more than 50% of its acreage is devoted to agricultural use.)

The bill provides that beginning January 1, 2001, the agricultural property recapture tax will be imposed if property meets all of the following conditions:

- It was transferred after December 31, 1999.
- It is "converted by a change in use" after December 31, 2000.
- The taxable value of the property was not adjusted to its SEV after its transfer, due to the provisions of Section 27a(7)(n) of the General Property Tax Act (under which a transfer of ownership does not include a transfer of qualified agricultural property if the new owner files an affidavit attesting that the property will remain qualified agricultural property).

Under the bill, "converted by a change in use" means either of the following:

- The property is no longer considered qualified agricultural property as determined by the assessor of the local tax collecting unit, due to a change in use.
- The purchaser of qualified agricultural property, prior to a transfer, files a notice of intent to rescind the qualified agricultural property exemption under Section 7ee of the General Property Tax Act, and delivers a copy of that notice to the seller. (Section 7ee exempts qualified agricultural property from local school district operating millage, but requires an owner to rescind the exemption within 90 days after the exempted property is no longer qualified agricultural property.) If the sale is not consummated within 120 days of the filing of the notice, then the property is not converted by a change in use.

The recapture tax imposed by the bill is "the benefit received on the property", which is calculated in the following manner:

$$\text{Benefit} = A \times (B-C)$$

"A" is the sum of the number of mills levied in the local tax collecting unit on the qualified agricultural property in each year of the "benefit period". The "benefit period" is the period in years between the date of the first exempt transfer (a conveyance that is not a transfer of ownership pursuant to Section 27a(7)(n) of the General Property Tax Act) and a conversion by a change in use, for up to seven years immediately preceding the year in which the qualified agricultural property is converted by a change in use. "B" is the "true cash taxable value" of the property in each year of the benefit period. ("True cash taxable value" is the taxable value the property would have had if Section 27a(7)(n) were not in effect.) "C" is the

property's taxable value.

Under the bill, the determination of who is responsible for paying the recapture tax is based upon how the qualified agricultural property is converted by a change in use. If the assessor of the local tax collecting unit determines that the property is no longer qualified agricultural property due to a change in use, the recapture tax is the obligation of the person who owned the property at the time the property was converted by a change in use. The tax is a lien on the property until paid. If the recapture tax is not paid within 90 days of the date the property was converted by a change in use, the treasurer may bring a civil action against the owner of the property as of the date it was converted by a change in use. If the recapture tax remains unpaid on March 1 in the year immediately succeeding the year in which the property was converted by a change in use, the property must be returned as delinquent to the county treasurer. Property returned as delinquent, and upon which the recapture tax, interest, penalties, and fees remain unpaid after it is returned as delinquent to the county treasurer, is subject to forfeiture, foreclosure, and sale for the enforcement and collection of the delinquent taxes as provided in the General Property Tax Act.

If qualified agriculture property is converted by a change in use because the purchaser files a notice of intent to rescind the qualified agricultural property exemption, the recapture tax is imposed on the person who owned the property before the transfer. The tax is due when the instruments transferring the property are recorded with the register of deeds, who may not record an instrument transferring the property before the recapture tax is paid.

The assessor of a local tax collecting unit must notify the county treasurer of the date qualified agricultural property is converted by a change in use.

The county treasurer must collect the recapture tax and deposit it with the State Treasurer. By the 15th day of each month, on a form prescribed by the State Treasurer, the county treasurer must itemize the recapture taxes collected the preceding month and transmit the form and the taxes to the State Treasurer. The county treasurer may retain the interest earned on the money collected while held by the county treasurer as reimbursement for the costs incurred by the county in collecting and transmitting the tax. The money retained by the county treasurer must be deposited in the treasury of the county in which the tax is collected, to the credit of the general fund.

The State Treasurer must credit the proceeds of the recapture tax collected by county treasurers to the fund in which the proceeds from lien payments made

under Part 361 of the Natural Resources and Environmental Protection Act are deposited. (Part 361 provides for development rights agreements between landowners and the State, which restrict development on the land for a specified period of time in exchange for credits against property taxes. The State may place a lien on the land, under certain circumstances, to recover the taxes if the land is removed from the confines of the agreement. Proceeds from lien payments are used by the State to purchase development rights and to administer Part 361. Beginning October 1, 2000, the unspent and unappropriated proceeds from lien payments made under Part 361 must be deposited in the Agricultural Preservation Fund (created by Public Act 262 of 2000). The Fund is to be used to administer Part 361; to provide grants to local units of government for the purchase of "agricultural conservation easements"; and to enable the State to purchase development rights or agricultural conservation easements. An "agricultural conservation easement" is a conveyance of property in which the owner relinquishes to the public in perpetuity his or her development rights and makes a covenant running with the land not to undertake development.)

The bill provides that it must be administered by the Revenue Division of the Department of Treasury.

MCL 211.27a (S.B. 709)  
211.1001-211.1007 (S.B. 1246)

## **ARGUMENTS**

*(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)*

### **Supporting Argument**

Farming remains an enormous part of the overall economy of Michigan. According to the Michigan Agriculture Statistics Service, the agricultural sector adds over \$4 billion to the State's economy each year. Nevertheless, farmers are facing difficult times. Agricultural prices, adjusted for inflation, are at their lowest levels since the depression, according to the Agricultural Preservation Task Force report. Some food processing plants have closed or moved out of the State. Low profitability in agricultural operations has caused many farmers to transfer their assets (land) to nonfarmers, usually developers. This has resulted in a steady reduction in the number of acres in farm production. Many people feel that this will have long-term negative consequences for society in general, because it will reduce the nation's ability to provide food for an ever-increasing population, and increase U.S. dependence on foreign producers.

Since the 1994 passage of Proposal A, which created a new State school funding system, there has been an assessment cap that limits a parcel's annual assessment increase to the rate of inflation or 5%, whichever is less. The assessment cap has led to substantial differences between the taxable value of farmland and its SEV (based on market value). While this has kept taxes lower than they otherwise would be, the cap is lifted when property is transferred. This means that if a young farmer wants to purchase a farm from a retiring farmer, the assessed value of the property--and the taxes on it--will "pop up" upon transfer of the land.

By ensuring that, when transferred, farm property will continue to be assessed based upon its capped value rather than its open-market value, Senate Bill 709 will prevent farmers' property taxes from rising dramatically, and thus will increase the farmers' chances of remaining profitable.

#### **Supporting Argument**

Taxes must be included in the cost of production; therefore, higher taxes result in lower profits. In the case of a transferred farm in a developing area, an assessment based upon the SEV rather than the farm's value under the assessment cap may preclude future use of the land for farming; that is, when the property is transferred either by sale or to an heir, the new assessment may raise the property taxes to the point at which the new owner can no longer make a viable profit by farming the land. The next logical step, then, is to sell the land to developers for residential, commercial, or industrial use, thus removing the land from farm production. Once this happens, the property is almost never returned to farmland. The State should take steps to ensure that agriculture remains a vital part of Michigan's economy, and to do that the State must do what it can to help farmers. By implementing one of several recommendations made by the Task Force to provide substantial tax relief to farmers, Senate Bill 709 will help to keep farmland as farmland.

#### **Supporting Argument**

Senate Bill 1246 institutes a tax that, upon a change in use, will recapture any benefit (for up to seven years) that a farmer has realized as a result of keeping his or her land in agricultural use. This creates a substantial incentive for an owner of farmland to keep it in agriculture.

#### **Opposing Argument**

The recapture tax provided for in Senate Bill 1246 has generated criticism from both developers and preservationists. Some people oppose any form of recapture tax when agricultural property is converted by a change in use, arguing that it infringes upon owners' property rights and restricts the owners' ability to do as they wish with their property. Others

argue that attempts to assist farmers through tax policy are diminished by a recapture tax, which penalizes not only those farmers who want to profit from the development of land, but the developers and all those who benefit directly and indirectly through the construction of residential and commercial areas. Still others contend that recapture tax revenues should not be placed in the new Agricultural Preservation Fund, to be used for the purpose of setting aside land for nondevelopment, because that will have the effect of reducing the availability of land for development and increasing the cost of the land that is left.

From another direction, others say that the recapture tax is inadequate; will do little to discourage the development of farmland; and in fact may (in conjunction with Senate Bill 709) encourage developers to purchase farms now, keep them in farming to take advantage of the lower taxes, and develop the land later. Some believe that the recapture tax should impose a higher penalty than just a repayment of the benefit received, in order not only to provide a stronger incentive to keep farmland in agricultural production, but also to supply the Fund with more money so that more land can be set aside for preservation.

Legislative Analyst: G. Towne

#### **FISCAL IMPACT**

The provisions in Senate Bill 709 will reduce property taxes by an estimated \$2.1 million in FY 2000-01. Local government property tax revenue will decline \$0.9 million and property taxes collected by schools (K-12, intermediate school districts, and community colleges) will decrease \$0.7 million from what they otherwise would be. State government will be affected by a \$0.5 million reduction in State education tax revenue, but also will have to pay an additional \$0.2 million to reimburse K-12 schools for their loss in local property taxes due to the State's guaranteed funding levels. The new recapture tax, which is created in Senate Bill 1246, is not expected to generate any meaningful amounts of revenue in FY 2000-01.

Fiscal Analyst: J. Wortley

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.