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SFA



BILL ANALYSIS

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Senate Bill 830 (Substitute S-2 as passed by the Senate)
Sponsor: Senator Ken Sikkema
Committee: Finance

Date Completed: 1-25-00

RATIONALE

Much has been said in recent years about how agriculture has come under increasing economic pressures. To address this and other issues related to agriculture, 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 food processing industries are causing agricultural resources, including land, to be removed from farm production. The report concludes that the fundamental cause of the problems in farming 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, one of the recommendations in the report states that exempting farm cooperatives from personal property taxes could increase the profitability of farmers. (Under Section 521(b)(1) of the Internal Revenue Code, farmers' cooperatives are farmers', fruit growers', or like associations organized and operated on a cooperative basis for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales (less the necessary marketing expenses), on the basis of either the quantity or the value of the products furnished by them; or for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over the supplies and equipment to them at actual cost, plus necessary expenses.)

Under the General Property Tax Act, personal

property that is used in agricultural operations, excluding retail sales and food processing operations, is exempt from taxation. Property used in agricultural operations includes machinery used to prepare a crop for market, as defined in the statute. This provision became the subject of litigation in which the Michigan Court of Appeals eventually decided that property used in farming operations is exempt, for farmers or anyone else, but property only indirectly used in farming operations, such as machinery used to prepare a crop for market, is exempt only for farmers. (This case is discussed below in **BACKGROUND**.) Thus, because a farm cooperative is not a farmer, the machinery used by its members to prepare a crop for market does not qualify for the exemption. It has been suggested that the Act be amended to exempt from the tax all machinery used in this manner.

CONTENT

The bill would amend the General Property Tax Act to exempt crop processing machinery from the personal property tax, by deleting a provision that at least 33% of the volume of the crops processed in the year ending on the applicable tax day, or in at least three of the immediately preceding five years, must have been grown by the farmer in Michigan who owns or uses the crop processing machinery.

MCL 211.9

BACKGROUND

Eaton Farm Bureau v Township of Eaton involved the Eaton Farm Bureau, a farmer-owned cooperative that provides storage, handling, drying, and trucking of agricultural products for its member farmers. The cooperative does not own or operate any farms, though the members do. The cooperative was assessed \$138,000 in 1993 for personal property it owned; it appealed to the Michigan Tax Tribunal on the basis that Section 211.9(j) of the General Property Tax Act exempts personal property actually used in agricultural operations. The Tribunal decided for the township, stating, "...the Legislature intended

farmer-owned cooperatives not be included in this exemption". Upon appeal, the Court of Appeals found that the Tribunal had erred as a matter of law; the language of the statutory exemption for "property actually being used in agricultural operations...", according to the Court, "...does not limit to whom the exemption may be applied, but refers only to the type of property that must be exempted". The Court noted that the last sentence of Section 211.9(j) limits the exemption to property used in agricultural operations, which includes machinery used to prepare a crop for market that does not substantially alter the form, shape, or substance of the crop, and is limited to cleaning, cooling, washing, pitting, grading, sizing, sorting, drying, bagging, boxing, crating, and handling. Under this exemption, at least 33% of the volume of the crops processed in the year ending on the applicable tax day, or in at least three of the immediately preceding five years, must have been grown by the farmer in Michigan who owns or uses the crop processing machinery. The Court further noted that it was unable to determine what portion of the property subject to taxation was properly exempt, and what portion was machinery that, "... falls afoul of the requirements described in the final sentence...". Thus, the Court vacated the Tribunal order, and remanded the case to the Tribunal for findings of fact and conclusions of law with respect to the last sentence (221 Mich App 663).

The decision was appealed to the Michigan Supreme Court, which returned the case to the Court of Appeals asking that it clarify its opinion (457 Mich 886 (1998)). Upon second examination, the Court of Appeals reiterated that the exemption for personal property directly used in agricultural operations is not restricted just to farmers; however, it also found that the last sentence limits the exemption for machinery that relates only indirectly to farming. According to the Court, this provision applies to such equipment "...only where a certain volume of the crops processed by the equipment in question is 'grown by the farmer in Michigan who is the owner or user of the crop processing machinery [emphasis added by the Court]'. The Court concluded, then, that only farmers, and not farm cooperatives, are entitled to the exemption for property that is only indirectly used in farming (231 Mich App 622).

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

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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.

As determined by the Michigan Court of Appeals, while the machinery used by farmers in agricultural operations is exempt from personal property taxes, machinery used by the members of a farmers' cooperative to prepare a crop for market is not exempt. This means that members of a farmers' cooperative who use the cooperative's equipment are liable indirectly for the tax. Farmers join together to form cooperatives in order to pool their resources in an effort to save money, particularly on large equipment that may be needed infrequently during the year. Applying the tax to the equipment of a farmers' cooperative in this manner works against the farmers' effort. Taxes must be included in the cost of production; therefore, higher taxes result in lower profits. By exempting from taxation all machinery used in agricultural operations, whether used by an individual farmer or a cooperative, the bill would allow equal tax treatment for both, and would implement one of the recommendations made by the Agriculture Preservation Task Force to provide tax relief to farmers.

Opposing Argument

While the machinery used by individual farmers to prepare a crop for market is exempt from the personal property tax, the Act specifically excludes the equipment of food processors from the exemption. By exempting all equipment used to prepare a crop for market, regardless of who is using it, the bill could lead food processors to request an exemption.

Response: The Act exempts "property actually being used in agricultural operations", and defines the term "agricultural operations". The Act then elaborates on that definition by referring to "machinery used to prepare the crop for market", and lists the activities that may be performed in this context (e.g., cleaning, pitting, and handling). Although some of these activities might sound like food processing, this language is relevant only to an explanation of agricultural operations.

Legislative Analyst: G. Towne

FISCAL IMPACT

Data are not available to accurately determine the fiscal impact.

Fiscal Analyst: R. Ross