



**House
Legislative
Analysis
Section**

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AGRICULTURAL USE TAX

**House Bill 4456 (Substitute H-4)
First Analysis (6-13-01)**

**Sponsor: Rep. Judson Gilbert III
First Committee: Agriculture and
Resource Management
Second Committee: Land Use and
Environment**

THE APPARENT PROBLEM:

Michigan has been losing about 75,000 acres of farmland each year and has lost over one million acres over the past 15 years, according to the Michigan Land Use Trust. The state lost over 1,000 farmers in the 1990's. Policymakers who are concerned about the loss of farmland in Michigan say that one contributing factor is the way in which the land is taxed. Michigan is said to be alone among states by not taxing farmland based on its agricultural value. Instead, farmland is taxed at market value, which includes the value the land has for potential developers. Farm property taxes in Michigan are about twice the national average per acre, say representatives of farming interests. (The state does, however, have a farmland preservation program, known as PA 116, which offers farmers lower taxes in exchange for a promise not to develop their land. This has been a beneficial program for farmers, but its impact has been reduced with the passage of Proposal A, which lowered property taxes for farmers as part of the new school financing system). While there might be no difference between the agricultural use value and the market value of farmland in areas of the state that are heavily agricultural, the difference can be substantial in areas where residential and commercial development are nearby. This leads to higher taxes for farmers on the fringe of development. These higher operating costs increase the pressure to sell for farmers operating in the midst of rapid residential and/or commercial development. Taxing farmland based on its agricultural use value, say proponents, could help keep farmers on the land by reducing their costs and helping to make their operations more profitable. Keeping farmers on the land also reduces urban sprawl, say preservationists, and preserves the rural character of the countryside. Farms, moreover, typically use fewer local services than residential or commercial property.

Attempts to put a constitutional amendment before the state's voters in order to require farmland to be

assessed based on agricultural use value failed to muster the necessary two-thirds support during the 1999-2000 legislative session. New legislation has been proposed that would allow local units of government the option of exempting farmland from property taxes and instead imposing a specific tax on farms based on agricultural use value.

THE CONTENT OF THE BILL:

The bill would create the Alternative Agricultural Production Tax Act under which farmland could be exempted from the general property tax and instead be subject to an alternative tax based on agricultural use value. The alternative tax would apply only to property for which an agricultural production exemption certificate had been approved by the local unit of government and the State Tax Commission. Such a certificate would only be available in an agricultural production district designated by a local unit of government (a township, village, or city). A certificate would be in effect for 12 years and would be automatically renewed for 6 years at the property owner's request if the owner had complied with the terms of the previous certificate. (However, the local unit could modify the boundaries of a district so that property was not eligible for renewal.) The property owner would also be required to enter into an agricultural production agreement in order for the certificate to be in effect. No certificate could take effect before December 31, 2002. A county could veto the creation of an agricultural production district; that is, it could terminate a district created by a local unit by means of a resolution enacted within 30 days after the establishment of the district.

(The bill's procedural provisions resemble those found in Public Act 198 of 1974, the Plant Rehabilitation and Industrial Development Districts Act. That act provides for a specific tax in lieu of

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general property taxes in order to provide tax abatements to manufacturers.)

Agricultural Use Value. Agricultural use value would be a value calculated by a method determined by the State Tax Commission in consultation with the Department of Agriculture. The method could not include sales of comparable agricultural property but would have to include 1) evidence of the productive capability of the property for agricultural use, including soil characteristics; 2) the average annual net return in the immediately preceding five-year period for typical agricultural property located in the same county, discounted by an appropriate interest rate; 3) the average rental income for typical agricultural property in the county; and 4) the actual value of the buildings or improvements on the agricultural property. The agricultural use value of a parcel would be subject to a cap: it could not increase from one year to the next by more than five percent or the increase in the consumer price index, whichever was less.

Repayment of Tax Benefits. If an exemption certificate was subsequently revoked or expired and was not renewed, if the property no longer qualified as agricultural property, or if the owner violated the agricultural production agreement, the property owner would be liable to the local unit of government for an amount equal to the difference between the alternative taxes paid on the property and the taxes that would have been paid if the property had been subject to general property taxes for each year the certificate had been in effect, up to seven years. (However, if an owner whose certificate expired requested renewal and was informed that the unit would not renew it, he or she would not be liable for the payment.) These funds would be credited to the state's Agricultural Preservation Fund. The local assessor would determine each year the amount of property taxes that would have been due on the property if an exemption certificate had not been in force, and would have to notify the State Tax Commission, the legislative body of each unit levying taxes on the property, and the holder of the exemption certificate of the determination. The bill would specify that if prior to a transfer of property, the purchaser filed a notice of intent to terminate the certificate and the agricultural production agreement with the local unit of government, then the person who owned the property prior to the transfer (e.g., the seller) would be liable for the repayment. This would apply only if the sale was consummated within 120 days of the filing of the notice. The notice of intent to terminate would have to be on a form prescribed by the Department of Treasury.

Agricultural Production District. Under the bill, the legislative body of a local unit of government could by resolution establish an agricultural production district within which it would be possible to levy the alternative tax. The district could consist of one or more parcels or tracts of agricultural property and the local unit could establish the district on its own initiative or upon a written request filed by property owners. The request would have to be filed with the local clerk by the owner or owners of 75 percent of the state equalized value of the agricultural property located within the proposed agricultural production district. Before adopting a resolution establishing a district, the local legislative body would have to give written notice by certified mail to all the owners of real property within the proposed district and hold a public hearing at which those owners and other residents and taxpayers of the unit would have a right to appear and be heard.

Exemption Certificate. If a district was established, the owner of agricultural property could file an application for an agricultural production exemption certificate with the local clerk. The application would have to contain or be accompanied by a general description of the property, a description of the proposed use of the property, and a legal description of the real property. The local legislative body would have to decide whether to approve or disapprove the exemption certificate within 60 days of receiving the application and after affording the applicant, the local assessor, and representatives of affected tax units an opportunity for a hearing.

In a resolution approving an application, the local legislative body would have to set forth a finding and determination that the granting of the certificate, considered together with the aggregate amount of certificates previously granted and in force, would not have the effect of substantially impeding the operation of the local unit or impairing the financial soundness of a taxing unit within which the agricultural land was located. If the application was disapproved, the reasons would have to be set forth in writing in the resolution. An applicant would have 10 days to appeal a disapproval to the State Tax Commission.

The local clerk would have to forward an approved certificate to the State Tax Commission within 60 days of approval or before October 31, whichever was first. Within 60 days of receiving an approved certificate or an appeal of a disapproval, the commission would have to determine if the property complied with the provisions of the new act. If the property did comply, the commission would issue an

exemption certificate for a 12-year period. A party aggrieved by the issuance, refusal to issue, revocation, transfer, or modification of a certificate could appeal from the finding and order of the commission as provided in the Administrative Procedures Act.

Agricultural Production Agreement. Within 30 days of the State Tax Commission issuing a certificate, the local clerk would have to prepare an agricultural production agreement and provide it to the property owner. If the property owner executed the agreement, the certificate would be subject to the agreement and would take effect on the immediately succeeding December 31. Once the certificate expired, the property owner would no longer be subject to the agreement. The agreement would have to contain the period of years that the certificate was to be in effect and a provision specifying that the property owner would have to maintain the property as agricultural property for that period of time or be subject to the repayments of tax benefits.

Property Tax Exemption. The agricultural property for which a certificate had been granted would then be exempt from ad valorem property taxes for as long as the certificate was in force and any lessee, occupant, user, or person in possession of that agricultural property would also be exempt from ad valorem taxes under Public Act 189 of 1953, which governs the taxation of lessees and users of tax-exempt property. Personal property that had been exempt under the General Property Tax Act would also be exempt from the alternative tax. If agricultural property was located in a renaissance zone, it would be exempt from the new alternative tax, except for special assessments, debt millages, school sinking fund levies, and school enhancement millages. A certificate and agreement could be transferred and assigned to a new owner or lessee as long as the property remained agricultural property.

Alternative Tax. The alternative agricultural production tax would be determined by multiplying 50 percent of the agricultural use value of the property by the total mills levied as ad valorem taxes by all taxing units in which the property was located. It would be an annual tax, payable at the same times, in the same installments, and to the same officer or officers as taxes collected under the General Property Tax Act and would be subject to an administrative fee, as with property tax collections. The revenues collected would also, with certain exceptions, be disbursed in the same way as property tax revenues. (These provisions governing the collection and disbursement of the alternative tax are similar to

those governing the industrial facility tax, an existing specific tax.) The exemption certificate would be terminated if the alternative tax was not paid. The tax would be a lien upon the real property.

The State Tax Commission would be authorized to promulgate rules necessary for the administration of the new act.

FISCAL IMPLICATIONS:

The House Fiscal Agency said, in its preliminary estimates of the bill as introduced, that the revenue loss could approach \$100 million annually. Of that, \$25 million would be state revenues from the six-mill state education tax and \$75 million would be local property tax revenues. (Fiscal Note dated 5-1-01)

An updated analysis is in progress based on the substitute version of the bill and the preliminary figures could be revised.

ARGUMENTS:

For:

The bill would provide a new approach to taxing farmland based on its value for agricultural purposes rather than its market value. Rather than impose a statewide system, it allows local units to create special districts within which farmland can be assessed based on its value as agricultural property rather than its value to developers. Then, it requires that farmers apply to local units (presumably townships) if they want to pay a "specific" tax based on agricultural use value rather than the property tax. This approach has several virtues: it retains local control over the tax base and over development strategy and it has the potential to provide tax relief for those who most need it, since local units likely would only participate if there were benefits to farmers in general, and individual farmers would likely only apply if the program benefited them over the long term. In many agricultural areas, say knowledgeable observers, agricultural property is already essentially assessed based on agricultural use. It is in the areas of the state where development has occurred or is encroaching that farmers face tax bills based on the value of their land as the potential site of new housing or new commercial ventures. To the extent local units and farmers decide to take advantage of this program, it will reduce the pressure on farmers to abandon agriculture and sell land for development. In participating areas, this will provide a tool for local units of government to use in combating urban sprawl. Since the exemption

certificate and production agreement are transferable, new owners of farms can avoid the large assessment increase that currently accompanies transfers of property.

Against:

The bill could have serious negative fiscal and budgetary implications, particularly to local school districts, intermediate school districts, and community colleges. While counties would get a veto over local plans to create the special agricultural tax abatement districts, the schools would only get to voice their views at a public hearing. The bill could reduce school revenues substantially. Some estimate the potential loss to the School Aid Fund at \$25 million or more annually, not counting losses from local millages that support ISD vocational-technical education and special education programs and from community college millages. The decision to allow these abatements could well be made by the local units with the least to lose (townships). Given the downturn in state revenues, and the difficulties facing the state budget, including the School Aid Fund, this is not a good time to reduce school revenues from the 6-mill state education property tax. Representatives of public schools point out that farmers already pay the 6-mill state education tax, as homeowners do, rather than the 24 mills (in combined local and state property taxes) that other commercial property owners pay.

Response:

Proponents of this proposal doubt that the revenue losses will be as high as these estimates. These losses assume a much larger rate of participation in the abatement program than is likely. Some proponents have calculated the revenue reductions to the state at perhaps \$12 million to \$18 million, while at least one representative of farming interests has pegged the potential losses closer to \$3 million or \$4 million, assuming 10 percent of the state's 10 million acres of farmland participates.

Against:

A number of concerns have been raised about the bill. Some critics would prefer that any repayment of tax benefits made by farmers who leave the program or violate an agreement go back to the local taxing units (townships, counties, schools, community colleges, etc.) that surrendered the revenue, and not to the state fund for purchasing development rights. Further, some proponents of preserving farmland believe that the repayment penalties should be large enough to discourage changing the use of property from farmland to other uses. This bill simply proposes the repayment of the tax benefits received.

This approach has been criticized in the past as simply lowering the holding costs of land until the land is developed. While this lowers costs for farmers, it may not be sufficient to preserve farmland over the long run. Another obvious criticism of the approach taken by this bill is that it will result in some farmers paying taxes at one level while other similarly situated farmers in the state will pay at higher levels. Previous proposals would have applied agricultural use value across the state as a whole and not made it a function of local decision making. There is no guarantee that the areas where farmland is under the most intense pressure will benefit from this proposal.

Response:

It should be pointed out that the proposal in the previous legislative session to apply agricultural use taxation statewide through a constitutional amendment could not muster the two-thirds support needed. This bill is an attempt to reduce farm taxes and preserve farmland through other means, emphasizing local control. It is an additional tool for local units to use. Moreover, by sending tax benefit repayments to the Agricultural Preservation Fund, the bill provides additional support to farmland preservation efforts. Money in that fund is to be used to provide grants to local units of government for the purchase of agricultural conservation easements or development rights. Some people consider this kind of program the best way to preserve farmland in the long run.

POSITIONS:

The Michigan Farm Bureau supports the bill. (6-12-01)

The Michigan Association of Home Builders supports the bill. (6-12-01)

The Michigan Townships Association supports the bill. (6-12-01)

The Department of Treasury is opposed to the bill. (6-12-01)

A representative of the Michigan Education Association testified in opposition to the bill. (6-12-01)

A representative of the Michigan Association of School Boards testified in opposition to the bill. (6-12-01)

A representative of the Oakland Intermediate Schools testified in opposition to the bill. (6-12-01)

The Michigan Association of School Administrators has indicated opposition to the bill. (6-12-01)

A representative of the Michigan Association of Counties testified in opposition to the bill. (6-12-01)
The Michigan Assessors Association has indicated opposition to the bill. (6-12-01)

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.