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SFA BILL ANALYSIS

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Senate Bill 763 (as enrolled) **PUBLIC ACT 421 of 2000**
Sponsor: Senator Mike Rogers
Committee: Farming, Agribusiness and Food Systems

Date Completed: 2-16-00

RATIONALE

For more than 25 years, Michigan has relied on development rights agreements as a method of preserving farmland by reducing the amount of property taxes that farmers pay on their agricultural land. Farmers who enroll in this tax-reduction program receive a tax credit equal to property taxes that exceed 7% of household income or adjusted business income. In exchange for the tax credit, farmers must keep their land in agricultural production. A development rights agreement must be for an initial term of at least 10 years, cannot be in effect for more than 90 years, and upon expiration may be renewed in seven-year increments. If a farmer chooses to let an agreement expire, then the tax credits received during the last seven years under the agreement must be repaid. If this amount is not paid within 30 days, a lien against the property will be recorded. The lien is payable when the land is sold, and the proceeds are placed in a lien fund. Money in the lien fund is used to purchase development rights on other agricultural property.

Since Michigan voters approved ballot Proposal A in 1994 as part of a school finance reform package, average property taxes on homestead and agricultural property have been reduced by almost one-half, even though a new State property tax of six mills for school operations is levied on all property subject to the property tax. Because of the significant decline in property taxes, however, farmers who enrolled their land in a development rights agreement apparently have less of a financial incentive to renew their agreements. This and other concerns about economic pressures facing the State's agricultural industry, including increased financial incentives to remove land from agricultural production, were among the issues examined by the Senate Agricultural Preservation Task Force. After receiving testimony from more than 250 persons, the Task Force issued a report in September 1999 that concluded 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 listed 12 recommendations for State action, including lowering the income threshold for farmers to participate in a development rights agreement in order to reduce a farmer's tax burden and encourage continued participation in the land preservation program.

CONTENT

The bill would amend Part 361 (Farmland and Open Space Preservation) of the Natural Resources and Environmental Protection Act to reduce the income threshold for an owner of farmland to participate in a farmland development rights agreement.

Currently, an owner of farmland and related buildings covered by one or more development rights agreements meeting the requirements of Part 361, who is required or eligible to file a return as an individual or claimant under the State Income Tax Act, may claim a credit against the State income tax liability for the amount by which the property taxes on the land and structures used in the farming operation, including the homestead, restricted by the development rights agreements exceed 7% of the household income as defined in the State Income Tax Act, excluding a deduction if taken under the Internal Revenue Code. Under the bill, a person could claim an income tax credit for the amount by which the property taxes exceeded 3.5% of household income.

In addition, the Act provides that an owner of farmland and buildings covered by a development rights agreement, to whom the income tax credit does not apply, may claim a credit against the single business tax for the amount by which property taxes on the land and structures exceed 7% of the owner's adjusted business income (subject to certain conditions). The bill would reduce that percentage to 3.5%.

MCL 324.36109

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

While Proposal A reduced property taxes, it virtually eliminated the effectiveness of a development rights agreement as a tax-cutting tool and a method of preserving farmland. According to the Task Force report, testimony from a representative of the Kalkaska County Extension Office illustrated the effect Proposal A has had on a typical farm in that area that is enrolled in a development rights program. Tax credits on land enrolled in the program have declined from $3,225 before voters approved Proposal A to $87 after the proposal's passage. The tax credit statewide has dropped from approximately $60 million to $20 million, according to the report. Thus, farmers enrolled in a development rights agreement are subject to limitations in the agreement, such as restricting land improvements to those that are consistent with farm operations, but no longer reap the financial benefits they had prior to the passage of Proposal A. Lowering the income threshold would restore the program's incentive of tax relief for farmers to remain in or apply for a farmland development rights agreement.

Supporting Argument

Approximately 40% of the State's farmland, or 4.29 million acres, was enrolled in the development rights and farmland preservation program as of 1998. Between January 1, 1998 and December 31, 2003, more than 1.7 million acres, or 40% of the land enrolled in the State's development rights agreements, is scheduled to leave development rights agreements. Given the small benefits of enrolling in the program since the passage of Proposal A, farmers are less likely to re-enroll when their contracts expire. Furthermore, as the amount of tax credits extended under the program declines, there will be less money in the fund that can be used to purchase development rights. To restore the development rights program as a method to reduce property taxes and preserve farmland, the State needs to strengthen the tax credit incentive for farmers to remain in the program.

Opposing Argument

The property tax credit provided under a development rights agreement extends to a farm's homestead as well as the farmland and related buildings. There is concern that not only farmers but certain residential property owners may apply for a development rights agreement to obtain a tax credit. Apparently, certain residential communities in the State require that homes be built on lots that measure at least five acres. Thus, these property owners can declare their land to be farmland in order to qualify for a tax credit. If the owners of this property as well as farmers are protected from property taxes that exceed 7% (or 3.5%) of their income, then perhaps all residential property should be protected.

Response: In order to qualify for a development rights agreement, the land and how it is used must meet certain requirements. Under the Act, the definition of "farmland" includes a farm of at least five acres but less than 40 acres, with at least 51% of the land area devoted to an agricultural use, that has produced a gross annual income from agriculture of at least $200 per year per acre of cleared and tillable land. In addition, an application for a development rights agreement must be reviewed by certain agencies and local governing bodies, approved by the local governing body holding the application, and submitted to the State for approval, before an agreement is prepared. Furthermore, farmhouses are used as part of a farm's operation. That is where the farmer's office is located and where farmhands often are fed.

Opposing Argument

If the purpose of a development rights agreement is to encourage families to keep farms in agricultural production and not sell their land to developers, then publicly held corporations that operate large farms, which can afford to pay their share of taxes, should not be able to qualify with a lower income threshold for the tax credit. Although incorporated farms in Michigan presently may be family-owned, the trend in agriculture is toward large corporate farms where pigs and chickens are processed. Shutting the door on potential abuse actually could help family farms, by reducing corporations' incentive to gobble up farmland.

Legislative Analyst: L. Arasim

FISCAL IMPACT

This bill would increase the cost of the farmland preservation tax credit, and therefore reduce net income tax revenue, by an estimated $11.7 million a year. This increase in the cost of the farmland preservation tax credit would be due to two factors: 1) Taxpayers currently receiving a credit, would experience an increase in the amount of their credit, and 2) some taxpayers who currently do not qualify for the credit would become eligible under the lower household income threshold. It is estimated that almost all of this loss in revenue would affect General Fund/General Purpose revenue.

Fiscal Analyst: J. Wortley

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