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SFA BILL ANALYSIS

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Senate Bill 692 (as passed by the Senate)
Sponsor: Senator Bev Hammerstrom
Committee: Farming, Agribusiness and Food Systems

Date Completed: 11-19-01

RATIONALE

The Natural Resources and Environmental Protection Act (NREPA) gives the State several ways to preserve agricultural property. Under Part 361 of the Act, the State and a land owner may enter into a farmland development rights agreement (FDRA), which entitles the owner to a tax credit in exchange for keeping the land in agricultural production for the term of the agreement. Part 361 also authorizes the State to purchase the development rights of farmland. In addition, under Part 362, eligible local units of government may purchase agricultural conservation easements. In either case involving a purchase, the land owner permanently relinquishes the right to develop the land for nonagricultural purposes.

A land owner who is enrolled in the FDRA program may sell the development rights to the State or a local unit, but doing so will result in a financial liability. Under the Act, if an FDRA is not renewed when its term expires, the land owner must repay the State for the tax credits received during the last seven years of the agreement. If the amount is not paid within 30 days, the State must record a lien against the property for the amount due. Also, if an FDRA is relinquished before its term expires, the land owner is liable for interest on the amount due. According to the Attorney General's office, an FDRA *must* be terminated when the State and a land owner enter into a purchase of development rights (PDR). This means that the land owner is liable for the repayment of tax credits, as well as interest in some cases, and no longer is eligible for a tax credit under the FDRA program. Some people see this as a disincentive for farmers to sell their development rights, and believe that the repayment and lien requirements should not apply in these situations.

CONTENT

The bill would amend Part 361 (Farmland and Open Space Preservation) and Part 362 (Agricultural Preservation Fund) of the Natural Resources and Environmental Protection Act to do the following:

- **Provide for the automatic termination of a farmland development rights agreement when the farmland became subject to a development rights easement.**
- **Provide that farmland would not be subject to a lien for tax credits received by the owner if, upon expiration of an FDRA, the farmland became subject to an agricultural conservation easement or purchase of development rights agreement or if the FDRA were automatically terminated when the farmland became subject to a development rights easement.**
- **Extend the income tax and single business tax credits to property subject to an agricultural conservation easement or PDR.**

Under the bill, a farmland development rights agreement would be automatically relinquished when the farmland became subject to a development rights easement under Part 361 or 362. The bill also provides that farmland would not be subject to a lien for seven years of tax credits if, upon expiration of the term of an FDRA, the farmland became subject to an agricultural conservation easement or purchase of development rights under Part 361 or 362, of if an FDRA were automatically relinquished as provided in the bill.

The NREPA permits the owner of land covered by an FDRA to claim a credit against the State income tax or single business tax for the amount by which the property taxes on the land and structures exceed 3.5% of the owner's household income or adjusted business income, as applicable. Under the bill, the tax credit also would be available to the owner of land subject to a purchase of development rights or an agricultural conservation easement under Part 361 or 362.

MCL 324.36105 et al.

BACKGROUND

Part 361

Farmland Development Rights Agreement. The FDRA program was created in 1974 upon the passage of the Farmland and Open Space Preservation Act (which later became Part 361 of the NREPA). Farmland eligibility for an agreement is based on the size of the farm and, in some cases, on its income. A land owner who wants to participate in the program must apply to the local governing body having jurisdiction (e.g., the legislative body of a city, if the land is located in a city), which then must notify various local agencies and approve or reject the application. If the application is approved, the local governing body must send it to the Michigan Department of Agriculture (MDA) for approval or rejection. If the MDA approves the application, it must prepare a farmland development rights agreement for execution by the land owner and the Department, and for recording with the register of deeds.

While an agreement is in effect, the land owner may claim a credit against the State income tax or single business tax for the amount by which the property taxes on the land and structures used in the farming operation restricted by the agreement exceed 3.5% of the land owner's household income or adjusted business income, as applicable. The land also is exempt from special assessments for sanitary sewers, water, lights, or nonfarm drainage unless the assessments were imposed before the agreement was recorded.

An FDRA must be for an initial term of 10 years and may not exceed 90 years. When its term expires, the agreement must be relinquished by the State unless it is renewed with the consent of the land owner. A land owner who has complied with Part 361 may renew the agreement for a term of at least seven years. Under certain circumstances, an FDRA or a portion of the land covered by an agreement may be relinquished before the termination date. The State must record a lien for the amount of the last seven years of tax credits, when an agreement is relinquished. The lien may be paid and discharged at any time, and is payable at the time the land is sold.

Until October 1, 2000, the proceeds from lien payments were used by the State to administer Part 361 and to purchase development rights on farmland. Since that date, the unappropriated proceeds of lien payments have been forwarded to the State Treasurer for deposit in the Agricultural Preservation Fund created under Part 362.

Purchase of Development Rights. Part 361 also authorizes the State to purchase development rights to farmland and to acquire agricultural conservation easements. The land owner must submit an application for a PDR or an easement to the Department of Agriculture, and include written support by the local governing body. The MDA must evaluate applications and rank them according to selection criteria and a scoring system approved by the Agriculture Commission. In the scoring system, points are given to farmland that meets certain criteria, including land that is enrolled in an FDRA. After negotiations with the land owner, the MDA must approve the price to be paid for the purchase of development rights or the acquisition of an agricultural conservation easement.

The NREPA defines "agricultural conservation easement" as a conveyance in which, subject to permitted uses, the owner permanently relinquishes to the public his or her development rights and makes a covenant running with the land (binding on future owners of the land) not to undertake development. Under certain circumstances, an easement may be terminated with the approval of the local governing body and the Agriculture Commission. If an easement is terminated, the current fair market value of the development rights must be paid to the MDA, which must use the payments to acquire agricultural conservation easements on additional farmland.

Part 362

Public Act 262 of 2000 added Part 362 to the NREPA. Public Act 262 created the Agricultural Preservation Fund and required the Department of Agriculture to establish a program in which eligible local units may receive grants for the purchase of agricultural conservation easements. (Public Act 262 also added the agricultural conservation easement provisions of Part 361.)

To be eligible for the grant program, a local unit must have adopted a development rights ordinance providing for a PDR program. The local unit also must have adopted a comprehensive land use plan (or be within a regional plan) that includes a plan for agricultural preservation. Upon receiving a local unit's application, the MDA must forward it to the Agricultural Preservation Fund Board for consideration. After the Board decides which grants should be awarded and their amount, the MDA distributes the grants, conditioned upon its approval of the easements being acquired. An agricultural conservation easement acquired under Part 362 must be held jointly by the State and the local unit of government in which the land is located.

Money in the Agricultural Preservation Fund may be spent, upon appropriation, for the following purposes:

-- To pay administrative costs of the MDA and the Board in implementing Parts 361 and 362 (subject to limits in the Act).
-- After the payment of administrative costs, to provide grants to local units of government for the purchase of agricultural conservation easements.
-- After the first two expenditures, if the amount of money in the Fund exceeds $5 million, to purchase development rights or acquire agricultural conservation easements under Part 361.

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

In recent years, the Attorney General's office has made it clear, through a title opinion letter and in memoranda, that a farmland development rights agreement must be terminated when the State purchases the same development rights that subject to the FDRA. This requirement is likely to affect the majority of cases in which a land owner transfers from an FDRA to a PDR, since land owners were enrolled in the FDRA program in nearly all of the PDR cases to date. Upon termination of the FDRA, the land owner will become liable for seven years of tax credits (plus interest, if the transfer occurs before the agreement has expired), and the State must record a lien for the amount that is not repaid within 30 days. At the same time, the land owner will lose the FDRA tax credit. Although these consequences are legally required, the affected land owner may consider them punitive, and be disinclined to transfer to a PDR.

The bill would address this situation by exempting farmland from the lien requirement if the land became subject to a PDR or an agricultural conservation easement, either during the term of the FDRA or when the agreement expired. In addition, the land owner would remain eligible for the tax credit allowed under the FDRA program. Encouraging farmers to sell their development rights in this way not only would benefit the individual land owners, but would help promote the State's interest in preserving agricultural property. While land subject to an FDRA must continue to be farmed, that agreement is only temporary. When development rights are purchased, the land is permanently protected from nonagricultural development.

Supporting Argument

According to the September 1999 report of the Senate Agricultural Preservation Task Force, the advantages of enrolling land in the FDRA program declined significantly due to the 1994 passage of Proposal A, which reduced average property taxes on homestead and agricultural property by almost one-half. Since the value of the tax credit is considerably lower than it used to be, there is less incentive for farmers to enroll in the program or to re-enroll when their agreement expires. Moreover, since tax credits are smaller, less money is paid into the Agricultural Preservation Fund when FDRAs terminate, which means that fewer funds are available to purchase development rights.

Along with other legislation addressing concerns raised by the Task Force, Public Act 421 of 2000 reduced the income threshold for a land owner to participate in the FDRA program. By increasing the amount of the credit and extending it to some taxpayers who did not previously qualify, Public Act 421 should help restore the program's effectiveness as a tax-cutting incentive. Senate Bill 692 would build on these reforms by preserving the tax credit for land owners who transferred from an FDRA to a PDR, as well as by extending the credit to farmland owners who sold their development rights without first being enrolled in an FDRA.

Legislative Analyst: S. Lowe

FISCAL IMPACT

The bill would decrease State revenue by extending the tax credits currently available only to land owners enrolled in an FDRA to land owners who are enrolled in a purchase of development rights or an agricultural conservation easement.

The bill would increase the cost of the farmland preservation tax credit, and therefore reduce net income tax revenue, by expanding the tax credit to land owners who transfer from an FDRA to a purchase of development rights or an agricultural conservation easement. According to Department of Treasury data, the average tax credit under the FDRA program in 2000 was $2,479. This figure is expected to increase in 2001 as a result of Public Act (PA) 421 of 2000, which decreased, from 7% to 3.5%, the income threshold for a land owner to participate in an FDRA. This increase in the tax credit due to PA 421 will result from two factors: 1) Taxpayers already receiving a credit, will experience an increase in the amount of their credit, and 2) some taxpayers who did not qualify for the credit will be eligible under the lower household income threshold. Factoring in the estimated impacts of the changes from PA 421, the estimated average tax credit will increase to $4,000.

The Department of Agriculture received over 300 applications for the next round of development rights purchases and anticipates that 12 to 14 will be selected for funding in 2001. A total of $5 million is available. Using these figures and the estimated 2001 average tax credit of $4,000, the bill would result in a total loss of revenue of $48,000 to $56,000 for the next round of purchase of development rights. The actual impact would be based on the household income and property taxes of the land owners selected for the purchase of development rights. Future impacts would be contingent on the number of PDR applications selected for funding and the associated household income and property tax levels. It is estimated that almost all of this loss in revenue would affect General Fund/General Purpose revenue.

In addition to the General Fund/General Purpose revenue impact, the bill would decrease deposits to the Agricultural Preservation Fund by exempting land owners from the repayment requirements when they transfer their property from an FDRA to a purchase of development rights. Assuming that 12 to 14 purchases of development rights are selected in 2001, the impact on the Agricultural Preservation Fund would be a loss of revenue of nearly $200,000, excluding any interest payments for early termination of an FDRA. Again, the future impact would be contingent on the number of PDR applications selected for funding and the associated household income and property tax levels. This revenue would not be available for future purchases of development rights.

Fiscal Analyst: C. Thiel