

FARMLAND PRESERVATION: AG. DISTRICTS

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House Bill 5030 (Substitute H-2)
Sponsor: Rep. Howard Walker
Committee: Land Use and Environment

Complete to 6-30-04

A SUMMARY OF HOUSE BILL 5030 (H-2) AS REPORTED FROM COMMITTEE

BRIEF SUMMARY: The bill would allow owners of farmland who place their property in special agricultural districts to claim a credit against either the single business tax or the income tax. The credit would be equal to the amount that property taxes on farmland and structures devoted to agricultural use exceed \$5 per acre. The program would only be available in local units that chose to participate. A local unit could only participate if it met certain criteria, including being located in a county that had implemented or updated a comprehensive land use plan in the previous five years, and if the local unit was in compliance with the plan. Participating property owners would have to enter into 20-year agricultural district contracts (renewable for 10 years) with the Department of Agriculture. The credits would apply for tax years after December 31, 2005.

The bill contains provisions allowing for the early withdrawal of farmland, with assessments to be levied against property owners, and for the relinquishment of land from contracts, with credits to be repaid with interest.

FISCAL IMPACT: This bill would reduce income tax and single business tax revenue by an estimated \$30 million. The fiscal impact would affect General Fund/General Purpose (GF/GP) revenue. Twenty counties have implemented or updated a comprehensive land use plan within the last 5 years. Local units within these counties would be able to participate in the program.

The following is a more detailed description of the bill, which would amend the Natural Resources and Environmental Protection Act (NREPA) to add a new Part 363, entitled Farmland Preservation – Agricultural Districts.

Agricultural district applications. An owner of farmland who wanted to establish an agricultural district would have to apply to the qualified local governing body using a form prescribed by the Department of Agriculture. The application would have to contain all of the following: 1) the terms, restrictions, and conditions governing the agricultural district, as set forth in this legislation; 2) information reasonably necessary to classify as farmland the land that would be covered by the agricultural district contract, including both a land survey or a legal description of the land and a map showing the significant natural features,

and all structures and physical improvements located on the land; and 3) assurances that the applicant agreed to all of the following: that a structure would not be built on the land except for use consistent with farm operations, which would include a residence for an individual essential to the operation of the farm, or lines or utility transmission or distribution purposes, or with the approval of the local governing body and the Department of Agriculture; that land improvements would not be made except for use consistent with farm operations, or with the approval of the local governing body and the Department of Agriculture; that public access would not be permitted on the land unless agreed to by the owner; that the owner of record at the time of early withdrawal would be responsible for the early withdrawal assessment; and any other conditions and restrictions on the land as agreed to by the parties that were considered necessary to preserve the land as farmland.

Application approval or rejection. A qualified local unit could charge an applicant a reasonable fee, not exceeding the cost of processing an application. If the local unit charged a fee, then the application would not be complete unless it had been accompanied by the fee. The clerk of the local governing body would be required to record the date of receipt of the application. Within 42 days, the local governing body would be required to do either of the following.

1) The local unit would approve the application if all the land proposed for the agricultural district was farmland, it was located within a qualified local unit, and all the structures were devoted to an agricultural use. [If no action were taken, then the application would be considered approved.]

2) The local unit would reject the application if any of the land proposed for inclusion in the district was not farmland, or not located within a qualified local unit, or if any of the structures were not devoted to an agricultural use. This action also would be recorded by the clerk, and the reasons for the rejection would be written on the application before it was returned to the owner.

Application rejection appeal. Within 28 days after a rejection, an owner could appeal by filing the rejected application with the state Department of Agriculture, and the department would have to either approve or reject the application, following a similar protocol to that described above for local governmental units. If approved, the application would be returned to the clerk of the local governing body; if rejected, then the reasons for rejection would be noted on the application, and it would be returned to the owner.

Recording agricultural district contracts; notice upon termination. Upon approval of an application, or upon receiving an application that had been approved by the Department of Agriculture, the department would be required to record the agricultural district contract with the register of deeds of the county in which the land was located. In addition, the department would be required to notify the applicant, the qualified local unit's assessing office, and the Department of Treasury that the contract had been recorded. The bill also specifies that a contract that was approved by November 1 would take effect on December 31 of that tax year.

The execution and acceptance of an agricultural district contract by the Department of Agriculture and the owner would contractually bind the owner to keep the farmland in an agricultural use for the terms of the contract, for which the initial term would be at least 20 years. The state or the local government body could not sell, transfer, convey, relinquish, vacate, or otherwise dispose of the contract except with the agreement of the owner. Under the bill, an agricultural district contract would not supercede any prior lien, lease, or interest that was properly recorded with the county register of deeds. A lien created in favor of the state or a local governing body would be subordinate to a lien of a mortgage that was properly recorded earlier.

All who owned land under an agricultural district contract would be required to notify the state or the local governing body holding the agricultural district contract, six months before the natural termination date of the contract, of the owners' intention regarding whether the contract should be extended or allowed to expire.

The bill specifies that the Department of Agriculture must notify the landowner by first class mail at least 10 years before the expiration of the contract that a lien may be placed at the time of expiration, if the landowner does not extend the contract. That notification would be required to indicate the option of not claiming credits during all or a portion of the next 10 years.

Special assessments. Special assessments on farmland in an agricultural district would be subject to section 36108 of the act.

Tax credit; eligibility. For the tax years that begin after December 31, 2005, an owner of farmland under an agricultural district contract who was required or eligible to file a return as an individual or a claimant under the state Income Tax Act could claim a credit against the state income tax liability for the amount that represented the difference between the property taxes on the farmland and structures used in the farming operation, and \$5 per acre. For the purposes of this section, *all* of the following would apply:

- a) A partner in a partnership would be considered an owner of farmland and related buildings covered by a contract. A partner would be considered to pay a proportion of the property taxes on that property equal to the partner's share, as reported by the partnership to the Internal Revenue Service, or, if the partnership was not required to report that information, then as provided in the partnership agreement, or if no agreement, then in a statement signed by all the partners. A partner claiming a credit would be required to file a copy of the agreement with his or her income tax return. If the agreement was not filed, then the Department of Treasury would deny credit. All partners would be required to compute the credit using the same basis for the apportionment of the property taxes.
- b) A shareholder of a corporation that had filed under the Internal Revenue Code would be considered an owner of farmland and related buildings covered by a contract and owned by the corporation. A shareholder would be considered to pay a proportion of

the property taxes equal to the shareholder's percentage of stock ownership for the tax year, as reported to the IRS.

- c) If an individual in possession of property for life under a life estate with remainder to another person, or holding property under a life lease enters into a written agreement with a person holding their remainder interest, and the written agreement apportions the property taxes in the same manner as revenue and expenses, then the life lease or life estate holder and the person holding the remainder interest could claim the credit as it was apportioned to them, upon filing a copy of the written agreement with the return.
- d) If a trust held farmland and related buildings covered by a contract, and an individual was treated under the federal Internal Revenue Code as the owner of that portion of the trust that included the farmland and related buildings, that individual would be considered the owner of the building.
- e) An individual who was the sole beneficiary of a trust that was the result of the death of that individual's spouse would be considered the owner of farmland and related buildings covered by the contract and held by the trust, if the trust conformed to all of the following: 1) 100 percent of the trust income was distributed to the beneficiary in the tax year in which the trust received the income; and 2) the trust terms did not provide that any portion of the trust was to be paid, set aside, or otherwise used in a manner that would qualify for the deduction allowed by the Internal Revenue Code.
- f) A member in a limited liability company would be considered an owner of farmland and related buildings covered by a contract that are owned by the company. A member would be considered to pay a proportion of the property taxes equal to the members' share, as reported by the company to the IRS.

Single business tax credit. Owners of farmland subject to contracts for whom the above did not apply, could claim a credit under the Single Business Tax Act for the amount that represented the difference between the property taxes on the land and structures, and \$5 per acre. A participant would not be eligible to claim a credit and refund against the Single Business Tax unless he or she demonstrated that agricultural gross receipts of the farming operation exceeded five times the property taxes on the land for each of three out of the past five years, preceding the year in which the credit was claimed. A participant could compare, during the contract period, the average of the most recent three years of agricultural gross receipts to property taxes in the first year, in calculating the gross receipts qualification. Once an election was made to compute the benefit in this manner, all future calculations would be made in the same manner.

If the farmland and related buildings covered by a contract were owned by more than one owner, then each owner would be allowed to claim a credit based on his or her share of the property tax. The Department of Treasury would be required to consider the property tax equally apportioned among the owners, unless a written agreement signed by all the owners was filed with the return. If the property taxes were equally apportioned, a husband and wife would be considered one owner, and a person with respect to whom a deduction was

allowable to another owner under the Internal Revenue Code would not be considered an owner.

Payment in lieu of credit. The bill specifies that if the allowable amount of the credit claimed exceeded the state income tax or the state single business tax otherwise due, or if no state income tax or the state single business tax were due, the amount of the claim not used as an offset against the state, after examination and review, would be approved for payment under the Revenue Act. The total credit allowable could not exceed the total property tax due and payable by the claimant in that year. The amount the credit exceeded the property tax due and payable would be deducted from the credit claimed.

For purposes of audit, review, determination, appeals, hearings, notices, assessments, and administration relating to the credit program, the Income Tax Act or Single Business Tax Act would apply according to which tax the credit was claimed against. If an individual were allowed to claim a credit based upon property owned or held by a partnership, S corporation, or trust, the Department of Treasury could require that the individual furnish to the department a copy of a tax return and supporting schedules that were filed under the Internal Revenue Code.

The bill specifies that the Department of Treasury could account separately for payments under this legislation, and not combine them with other credit programs. A payment made to a claimant for a credit claimed would be issued by one or more warrants made out to the claimant.

Change of property ownership. The bill specifies that land subject to an agricultural district contract could be sold without penalty if the use of the land by the successor in title complied with the provision contained in the contract. The seller would be required to notify the governmental authority over the agricultural district contract of the change in ownership. Further, the bill describes the protocols that would be followed in the event of changes in ownership due to death or total permanent disability, as well as to the division of the land into smaller parcels and the creation of separate agricultural district contracts.

Renewal of contracts. An agricultural district contract would expire unless it were renewed with the consent of the owner of the land. The owner would be entitled to automatic renewal if he or she had complied with the law. The contract could be renewed for a term of not less than 10 years, and if it were renewed, the Department of Agriculture would be required to send a copy of the renewal contract to the local governing body of the local unit of government in which the farmland was located.

Relinquishment. Farmland may be relinquished by the state before the termination date of a contract under either of the following circumstances.

- a) If approved by the local governing body and the Department of Agriculture, land containing structures that were present before the recording of the district contract could be relinquished from the contract. Not more than two acres could be relinquished, unless additional land area was needed to encompass all of the buildings

and structures located on the parcel, in which case not more than five acres could be relinquished. If the parcel proposed was less in area than the minimum parcel size required by local zoning, then the parcel could not be relinquished unless a variance was obtained from the local Zoning Board of Appeals.

- b) If approved by the governing body and the department, land could be relinquished from the contract for the construction of a residence by an individual that was essential to the operation of the farm. Not more than two acres could be relinquished for this purpose. If the parcel proposed was less in area than the minimum parcel size required by local zoning, then a variance would be necessary from the Zoning Board of Appeals.

If the relinquishment were approved, then the Department of Agriculture would prepare an instrument, and record it with the register of deeds of the county in which the land was situated. If the district or a portion of it were to be relinquished, the Department of Agriculture would record a lien against the property formerly subject to the contract for the total amount of the allocated tax credit of the last 10 years, including the year of termination, received by an owner for that property, plus interest at the rate of 6 percent per annum, from the time the credit was received until the lien was placed on the property. If the property being relinquished was less than all of the property, the allocated tax credit for district contract would be multiplied by the property's share of the taxable value of the contract. [The bill includes a definition for the terms "allocated tax credit," and "the property's share of the taxable value of the agreement."]

Liens. Thirty days before recording a lien, the Department of Agriculture would have to notify the owner of the farmland of the amount of the lien, including interest, if any. If the lien amount were paid before 30 days after the owner was notified, the lien would not be recorded. The lien could be paid and discharged at any time and would be payable to the state by the owner at the time the land or any portion of it was sold by the owner, or if the land was converted to a use prohibited by the former agricultural district contract. Upon termination of an agricultural district contract, the Department of Agriculture would have to notify the Department of Treasury for their records. The manner in which the lien would be calculated is included at section 36311(10)(a) and (b) of the bill. When a lien is paid, the Department of Agriculture would be required to prepare and record a discharge of lien with the register of deeds in the county where the land was located.

Upon request from a landowner and a local government body, the Department of Agriculture would be required to relinquish farmland from the contract, if one or both of the following occurred:

- a) the local governing body determined that 1) because of the quality of the land, agricultural production could not be made economically viable; 2) surrounding conditions imposed physical obstacles to agricultural operation or prohibited essential agricultural practices; 3) significant natural physical changes had occurred that were generally irreversible and permanently limited the productivity of the farmland; 4) a court order

restricted the use of the farmland so that agricultural production could not be made economically viable; or,

b) the local governing body determined that the relinquishment was in the public interest and that the farmland met one or more of the following conditions: 1) the farmland was owned, operated, and maintained by a public body for a public use; 2) it had been zoned for the immediately preceding three years for a commercial or industrial use; 3) it had been zoned for commercial or industrial use, and the relinquishment of the farmland would be mitigated by the mitigation protocol that is outlined in the bill—an agricultural conservation easement that would allow two acres for each acre relinquished, or an amount equal to twice the value of the development rights to the farmland being relinquished; 4) the farmland was to be owned, operated, and maintained by an organization exempt from taxation under the Internal Revenue Code, and the relinquishment would be beneficial to the local community. Under the bill, three criteria are included to determine public interest.

Appeals. If a landowner's relinquishment application was denied by the local governing body, the landowner could appeal to the Department of Agriculture. The bill specifies the criteria the department would use to decide the appeal. Under the bill, a local governing body could waive its right to make a relinquishment determination by providing written notice to the Department of Agriculture. That notice would grant the department sole authority to grant or deny the application. A decision by the department that adversely affect a landowner or a local governing body would be subjected to a contested case hearing as provided under the Administrative Procedures Act.

Early withdrawal assessments. The owner of farmland subject to an agricultural district contract could, upon written request to the Department of Agriculture between January 1 and April 1, in the 10th and 15th years of the initial term of the contract, elect to terminate the contract upon payment of an early withdrawal assessment. The assessment would be as follows:

- a) in the 10th year, an amount equal to seven percent of the true cash value of the farmland subject to the contract;
- b) in the 15th year, an amount equal to 5 percent of the true cash value of the farmland subject to the contract.

Agricultural preservation fund. The un-appropriated proceeds from lien payments and early withdrawal assessments would be forwarded to the state treasurer for deposit in the Agricultural Preservation Fund.

Rules. The Department of Agriculture would be authorized to promulgate rules to implement this legislation under the Administrative Procedures Act.

Definitions. The bill would define several key terms, among them “agricultural district contract,” “agricultural use,” “conservation easement,” “economic viability,” “farmland,” “permitted use,” “qualified local unit,” and “true cash value.”

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■ 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.