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BILL ANALYSIS

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House Bill 5030 (Substitute H-2 as passed by the House)
Sponsor: Representative Howard Walker
House Committee: Land Use and Environment
Senate Committee: Agriculture, Forestry and Tourism

Date Completed: 9-22-04

CONTENT

The bill would add Part 363 (Farmland Preservation - Agricultural Districts) to the Natural Resources and Environmental Protection Act (NREPA) to allow a farmland owner to enter into a 20-year agricultural district contract with the Michigan Department of Agriculture (MDA) to keep the land in agricultural use; and allow the owner to claim a credit against either the State income tax or the single business tax (SBT) for tax years beginning after December 31, 2005. The bill would do the following:

-- Require the State to reimburse the State School Aid Fund (SAF) for all revenue lost as a result of the credits.
-- Establish procedures for the relinquishment of land subject to an agricultural district contract, and require a lien against the land to be recorded under certain circumstances.
-- Require the State land use agency (the MDA) to relinquish farmland if it were in the public's best interest and the farmland met certain conditions.
-- Provide for an assessment to be levied on a farmland owner for early withdrawal from an agricultural district contract.
-- Allow the MDA to promulgate rules to implement proposed Part 363.

Agricultural District Contract Application

Filing Application. An owner of farmland who desired to establish an agricultural district consisting of that farmland could file a signed application with the local governing body of the qualified local unit in which the farmland was located. The owner would have to apply on a form prescribed by the MDA.

The qualified local unit could charge an applicant a reasonable assessment, not to exceed the cost of processing an application. If the qualified local unit charged an assessment, the application would not be complete unless it was accompanied by the assessment.

The bill would define "farmland" as one or more of the following:

-- A farm of at least 40 acres in one ownership, with at least 51% of the land area devoted to an agricultural use.
-- A farm of at least five acres in one ownership, but less than 40 acres, with at least 51% of the land area devoted to an agricultural use, that produced a gross annual income from agriculture of at least $200 per year per acre of cleared and tillable land. (A farm enrolled in a Federal acreage set aside program or a Federal conservation reserve program would be considered to meet the gross annual income requirement.)
-- A farm designated by the MDA as a specialty farm in one ownership that produced a gross annual income from an agricultural use of at least $2,000. (Specialty farms would include greenhouses; equine breeding and grazing; the breeding and grazing of cervidae, pheasants, and other game

animals; bees and bee products; mushrooms; aquaculture; and other similar uses and activities.)
-- Parcels of land in one ownership that are not contiguous but constitute an integral part of a farming operation being conducted on land otherwise qualifying as farmland.

Farmland would not include farmland subject to a development rights agreement under Part 361. Farmland also would not include property exempt under Section 7cc of the General Property Tax Act, and surrounding property sufficient to equal the minimum lot size if the local governing body had implemented a minimum lot size by ordinance. (Under Section 7cc of the General Property Tax Act, a principal residence is exempt from the tax levied by a school district for school operating purposes, as specified in the Revised School Code.)

The bill would define "agricultural use" as it is defined under Section 36101 of NREPA, i.e., the production of plants and animals useful to humans, including forages and sod crops; grains, feed crops, and field crops; dairy and dairy products; poultry and poultry products; livestock, including breeding and grazing of cattle, swine, captive cervidae, and similar animals; berries; herbs; flowers; seeds; grasses; nursery stock; fruits; vegetables; Christmas trees; and other similar uses and activities. For purposes of proposed Part 363, the term would not include a residence for agricultural laborers.

Under the bill, "local governing body" would mean the legislative body of the qualified local unit. A "qualified local unit" would be a local unit that adopted a resolution to participate under the Act and was located in a county that had implemented or updated a comprehensive land use plan within the immediately preceding five years and was in compliance with the plan.

"Comprehensive land use plan" would mean a land use plan adopted by a county that contained an agricultural preservation component consisting of all of the following:

-- A future land use map of the county indicating areas intended for agricultural and farmland preservation.
-- A description of the strategies intended to be used to preserve the agricultural land and farmland in the county.
-- A description of the reasons why agricultural land and farmland should be preserved in the county.
-- A description of how and why the specific agricultural land and farmland were selected for preservation.
-- A description of any joint planning plans or agreements under the Joint Municipal Planning Act.

Application. The application would have to contain the following:

-- The terms, restrictions, and conditions governing the agricultural district as set forth in Part 363.
-- Information reasonably necessary to classify as farmland the land to be covered by the agricultural district contract, including a land survey or a legal description, and a map showing the significant natural features and all structures and physical improvements located on the land.

The application also would have to provide that the applicant agreed to all of the following:

-- That a structure could 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 for utility transmission or distribution purposes or with the approval of the local governing body and the MDA.
-- That land improvements could not be made except for use consistent with farm operations or with the approval of the local governing body and the MDA.
-- That public access would not be permitted on the land without the owner's agreement.
-- That the owner of record at the time of early withdrawal would be responsible for the early withdrawal assessment.
-- Any other condition and restriction on the land as agreed to by the parties that was considered necessary to preserve the land or appropriate portions of it as farmland.

"Individual essential to the operation of the farm" would mean a co-owner, partner, shareholder, farm manager, or family

member, who, to a material extent, cultivated, operated, or managed farmland under Part 363. An individual would be considered involved to a material extent if either of the following applied:

-- He or she had a financial interest equal to at least one-half the cost of producing the crops, livestock, or products and inspected and advised and consulted with the owner on production activities.
-- He or she worked at least 1,040 hours annually in activities connected with production of the farming operation.

Approval or Rejection. The clerk of the local governing body would have to record the date of receipt on the application. Within 42 days after receipt, the local governing body would have to approve or reject the application. Approval would be required if all the land proposed for inclusion in the agricultural district were farmland, the local unit in which the land was located were a qualified local unit, and all of the structures proposed for inclusion were devoted to an agricultural use. The clerk promptly would have to record the body's approval and the date of the approval on the application and sign it.

The local governing body would have to reject the application if the land proposed for inclusion were not farmland, the local unit were not a qualified local unit, or any of the structures proposed for inclusion were not devoted to an agricultural use. The clerk promptly would have to record the local governing body's rejection, the date of the rejection, and the reasons for the rejection on the application, sign the application, and return it to the owner.

If the local governing body did not act by the required date, the body would be considered to have approved the application on that date.

Within 28 days after an application was rejected, the owner could appeal the rejection by filing the rejected application with the MDA. Within 42 days after receiving the rejected application, the MDA would have to approve or reject the application on the same grounds required for local approval or rejection. If the MDA approved the application, an authorized MDA employee would have to record the approval and the approval date on the application; sign the application, which would then constitute the legally binding agricultural district contract; and return the application to the clerk of the local governing body. If the MDA rejected the application, an authorized MDA employee would have to record the rejection, the date of the rejection, and the reasons on the application, sign the application, and return it to the owner.

Contract

Upon approval of an application by the local governing body or the MDA, the MDA would have to record the agricultural district contract with the register of deeds of the county in which the land was located, and notify the applicant, the qualified local unit's assessing office, and the Department of Treasury. 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 MDA and the owner contractually would bind the owner to keep the farmland in an agricultural use for the term specified in the contract. A contract would have to be for an initial term of at least 20 years.

Except as otherwise provided in Part 363, the State or local governing body could not sell, transfer, convey, relinquish, vacate, or otherwise dispose of an agricultural district contract except with the owner's agreement. A contract would not supersede any prior lien, lease, or interest that was properly recorded with the county register of deeds. A lien created under Part 363 in favor of the State or a local governing body would be subordinate to a lien of a mortgage that was recorded in the office of the register of deeds before the recording of the lien of the State or local governing body.

Expiration; Extension

All participants owning land under an agricultural district contract would have to notify the State or local governing body holding the contract, six months before the natural termination date of the contract, of the owners' intentions regarding whether the contract should be extended or allowed to expire. The notice would have to be on a form provided by the MDA for informational purposes only.

The MDA would have to notify the landowner via first-class mail at least 10 years before a contract's expiration that a lien could be placed at the time of expiration on the farmland if the landowner did not extend the contract. The MDA also would have to indicate to the landowner the option of not claiming credits during all or a portion of the next 10 years.

A contract would expire at the expiration of its term unless renewed with the owner's consent. If the owner complied with the requirements of Part 363 regarding agricultural district contracts, the owner would be entitled to automatic renewal of the farmland covered by the contract upon the owner's written request. A contract could be renewed for a term of at least 10 years. If a contract were renewed, the MDA would have to send a copy of the renewal contract to the governing body of the local unit of government in which the farmland was located.

Special Assessments

Special assessments on farmland in an agricultural district would be subject to Section 36108. That section prohibits a city, village, township, or other governmental agency from imposing special assessments for sanitary sewers, water, lights, or nonfarm drainage on land for which a development rights agreement or easement has been recorded, unless the assessment was imposed before the agreement or easement was recorded.

(Under Part 361, "development rights" means an interest in land that includes the right to construct a building or structure, to improve land for development, to divide a parcel for development, or to extract minerals incidental to a permitted use or as set forth in a recorded instrument. A "development rights agreement" is a restrictive covenant, evidenced by an instrument in which the owner and the State, for a term of years, agree jointly to hold the right to undertake development of the land, and that contains a covenant running with the land, for a term of years, not to undertake development, subject to permitted uses. A "development rights easement" is a grant, by an instrument, in which the owner relinquishes to the public in perpetuity or for a term of years the right to undertake development of the land, and that contains a covenant running with the land, not to undertake development, subject to permitted uses.)

Tax Credits

For tax years beginning after December 31, 2005, a farmland owner subject to an agricultural district contract could claim a credit against the owner's income tax or SBT liability for the amount that represented the difference between the property taxes on the farmland used in the farming operation subject to the contract, and $5 per acre for each acre subject to the contract.

A farmland owner who was required or eligible to file a return as an individual or a claimant under the State's Income Tax Act, could claim the credit against his or her income tax liability. For the purposes of the credit, the bill describes who would be considered an owner of farmland and related buildings, and the proportion of property taxes the person would be considered to pay, in situations involving a partnership, an S corporation, a life estate or life lease, a trust that included the farmland and related buildings, a trust that resulted from the death of a spouse, or a limited liability company. A beneficiary of an estate or trust to which these provisions did not apply, would be entitled to the same percentage of the credit provided as that person's percentage of all other distributions by the estate or trust.

A farmland owner to whom the income tax provisions did not apply could claim the credit under the SBT Act. A participant would not be eligible to claim the SBT credit and refund unless the participant demonstrated that the participant's agricultural gross receipts of the farming operation exceeded five times the property taxes on the land for each of three out of the five years immediately 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 that the owner was subject to an agricultural district contract in calculating the gross receipts qualification. Once the participant made an election to compute the benefit in this manner, all future calculations would have to be made in the same manner.

If the farmland covered by an agricultural district contract were owned by more than one owner, each owner would be allowed to claim a credit based upon that owner's share of the property tax payable on the farmland. The Department of Treasury would have to consider the property tax equally apportioned among the owners unless a written agreement signed by all the owners were filed with the return, apportioning the property taxes in the same manner as all other items of revenue and expense. If the property taxes were considered equally apportioned, a husband and wife would be considered one owner, and a person with respect to whom a deduction under Section 151 of the Internal Revenue Code was allowable to another owner of the property would not be considered an owner. (Section 151 allows a $2,000 exemption in computing taxable income for the taxpayer, his or her spouse, and each of his or her dependents.)

If the allowable amount of the credit claimed exceeded the income tax or SBT otherwise due for the tax year or if there were no income tax or SBT due for the tax year, the amount of the claim not used as an offset against the income tax or the SBT, after examination and review, would have to be approved for payment to the claimant pursuant to the revenue Act. The total credit allowable under the bill and Chapter 9 of the Income Tax Act (which provides for the homestead property tax credit) or the SBT Act could not exceed the total property tax due and payable by the claimant in that year. The amount by which the credit exceeded the property tax due and payable would have to be deducted from the credit claimed under the bill.

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

The Department would have to account separately for payments under proposed Part 363 and could not combine them with other credit programs. A payment made to a claimant for a credit would have to be issued by one or more warrants made out to the claimant.

The State would have to reimburse the State School Aid Fund for all revenue lost as the result of the tax credits.

Relinquishment Subject to a Lien

An agricultural district contract or a portion of the farmland covered by a contract could be relinquished as provided in the bill.

If approved by the local governing body and the MDA, the State could relinquish up to two or five acres of farmland before the termination date contained in a contract as follows:

-- Land containing structures that were present before the recording of the contract could be relinquished from the contract. Up to two acres could be relinquished, unless additional land area was needed to encompass all of the buildings and structures, in which case up to five acres could be relinquished.
-- Land could be relinquished for the construction of a residence by an individual essential to the operation of the farm. Up to two acres could be relinquished.

In either case, if the parcel were smaller than the minimum parcel size required by local zoning, the parcel could not be relinquished unless a variance was obtained from the local zoning board of appeals.

If the request for relinquishment of the contract were approved, the MDA would have to prepare an instrument and record it with the county register of deeds.

If the district or a portion of it were to be relinquished, the MDA would have to 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 under the agreement, attributable to the property formerly subject to the contract, plus interest at the rate of 6% annual simple

interest from the time the credit was received until the lien was placed on the property. If the property being relinquished were less than all of the property subject to the contract, the allocated tax credit for the contract would have to be multiplied by the property's share of the taxable value of the contract.

("Allocated tax credit" would mean the amount obtained by multiplying the owner's total farmland preservation credit claimed in that year on all contracts by the quotient of the ad valorem property tax levied in that year on property subject to the contract that included the property being relinquished from the contract divided by the total property taxes levied on property subject to any contract and used in determining the farmland preservation credit in that year. "Property's share of the taxable value of the agreement" would mean the quotient of the taxable value of the property being relinquished from the contract divided by the total taxable value of property subject to the contract that included the property being relinquished.)

Also, upon relinquishment of all or a portion of the farmland under these provisions, the MDA would have to prepare and record a lien against the property formerly subject to a contract by establishing a term of years by multiplying 10 by a fraction, the numerator of which was the number of years the farmland was under the contract, including any extensions, and the denominator of which was the number representing the term of years of the contract, including any extensions. The lien amount would equal the total amount of the allocated tax credit claimed attributable to that contract in the immediately preceding term of years as determined in this calculation.

Thirty days before the recording of a lien, the MDA would have to notify the owner 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 could not be recorded. The lien could be paid and discharged at any time and would be payable to the State by the owner of record at the time the land or any portion of it was sold by the owner of record, or if the land were converted to a use prohibited by the former contract. The lien would have to be discharged upon renewal of or reentry into a contract, except that a subsequent lien could not be less than the discharged lien.

When a lien was paid, the MDA would have to prepare and record a discharge of lien with the county register of deeds. The discharge of lien specifically would have to state that the lien had been paid in full, that the lien was discharged, that the contract was terminated, and that the State had no further interest in the land under that contract.

Relinquishment without a Lien

Upon request from a landowner and a local governing body, the MDA would have to relinquish farmland from the contract if the local governing body determined any of the following:

-- That, because of the farmland's quality, agricultural production could not be made economically viable with generally accepted agricultural and management practices.
-- That surrounding conditions imposed physical obstacles to the agricultural operation or prohibited essential agricultural practices.
-- That significant natural physical changes in the farmland that were generally irreversible and permanently limited the farmland's productivity, had occurred.
-- That a court order restricted the use of the farmland so that agricultural production could not be made economically viable.

The MDA also would have to relinquish the farmland if the local governing body determined that the relinquishment was in the public's best interest and that the farmland met any of the following conditions:

-- The farmland was to be owned, operated, and maintained by a public body for public use.
-- The farmland had been zoned for the immediately preceding three years for a commercial or industrial use.
-- The farmland was to be owned, operated, and maintained by a nonprofit organization exempt from taxation under Section 501(c)(3) of the Internal Revenue Code, and the relinquishment would be beneficial to the local community.

In addition, the MDA would have to relinquish the land if the local governing body determined that it would be in the public's best interest, and that the farmland was zoned for commercial or industrial use and the relinquishment of the farmland would be mitigated by one of the following means:

-- For every acre of farmland to be relinquished, an agricultural conservation easement would be acquired over two acres of farmland of comparable or better quality located within the same local unit of government. The easement would have to be held by the local unit of government, or if it declined to hold the easement, by the MDA.
-- If an easement could not be acquired as provided above, an amount equal to twice the value of the development rights to the farmland being relinquished, as determined by a certified appraisal, would be deposited into the State Agricultural Preservation Fund.

In determining public interest, the governing body would have to consider all of the following:

-- The long-term effect of relinquishment upon the preservation and enhancement of agriculture in the surrounding area, including any nonfarm encroachment upon other agricultural operations in the surrounding area.
-- Any other reasonable and prudent site alternatives to the farmland to be relinquished.
-- Any infrastructure changes and costs to the local governmental unit that would result from the development of the farmland to be relinquished.

If a landowner's relinquishment application were denied by the local governing body, the landowner could appeal that denial to the MDA. In determining whether to grant the appeal and approve the relinquishment, the MDA would have to follow the criteria, described above, related to the farmland's physical changes and economic viability, or follow the criteria related to the farmland's public use, zoning, and relinquishment mitigation. The MDA also would have to consider the factors described above related to the determination of the public interest.

The MDA would have to review an application approved by the local governing body to verify that the economic viability and physical change criteria were met or the criteria related to the farmland's public use, zoning, and relinquishment mitigation were considered. If the local governing body did not render a determination, the MDA could not relinquish the farmland from the development rights agreement.

A local governing body could elect to waive its right to make a relinquishment determination by providing written notice to the MDA. The notice would have to give the MDA sole authority to grant or deny the application.

The MDA's decision to grant or deny an application for relinquishment that adversely affected a landowner or local governing body would be subject to a contested case hearing as provided under NREPA and the Administrative Procedures Act.

The local governing body or MDA would have to evaluate an application for relinquishment, and determine the economic viability of the affected farming operation, by doing all of the following:

-- Estimating crop, livestock, or product value of the farmland using locally accepted production methods and local U.S. Department of Agriculture (USDA) yield capabilities for the specific soil types and average price for crop, livestock, or product over the last five years.
-- Adding average yearly property tax credits afforded by the agricultural district contract over the immediately preceding five-year period.
-- Subtracting estimated expenses directly attributed to the production of the crop, livestock, or product, including seed, fertilizer, insecticide, building and machinery repair, drying, trucking, and property taxes.
-- Subtracting the estimated cost of the operator's labor and management time at rates established by the USDA for "all labor", Great Lakes area, as published in the USDA labor reports.
-- Subtracting typical capital replacement cost per acre of nonland assets using a useful life depreciation rate for comparable farming operations.

Relinquishment upon Death or Disability

If the owner of land subject to a contract, or an individual essential to the farm's operation, died or became totally and permanently disabled, the land could be relinquished from the contract under Part 363 and would be subject to a lien as described above. A request for relinquishment could be made only by the owner in case of a disability or, in case of death, the person who became the owner through survivorship or inheritance.

If an owner became totally and permanently disabled or died, land containing structures that were present before the recording of the development rights agreement could be relinquished from the contract, upon request of the disabled contract holder or upon request of the person who became the owner through survivorship or inheritance, and upon approval of the local governing body and the MDA. Up to two acres could be relinquished unless additional land area were needed to encompass all of the buildings located on the parcel, in which case up to five acres could be relinquished. If the parcel were smaller than the minimum parcel size required by local zoning, the parcel could not be relinquished unless a variance were obtained from the local zoning board of appeals. The relinquished portion of farmland would be subject to a lien.

Sale & Division of Land

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 provisions contained in the contract. The seller would have to notify the governmental authority having jurisdiction over the contract of the change in ownership.

The land described in an agricultural district contract could be divided into smaller parcels of land, each of which would have to be covered by a separate contract and each of which would have to be eligible for subsequent renewal. The separate contracts would have to contain the same terms and conditions as the original contract. The smaller parcels would have to meet the minimum requirements for being enrolled under Part 363 or be at least 40 acres. Farmland could be divided once without fee by the MDA. The MDA could charge a reasonable fee that did not exceed its actual costs of dividing the agreement for all subsequent divisions of that farmland. When a division of a contract was made and executed and recorded, the MDA would have to notify the applicant, the local governing body and its assessing office, and the Department of Treasury.

The MDA could charge and collect a fee of $25 to process each change of ownership or each subdivision. The MDA would have to use the fee to administer NREPA.

Other Termination Provisions

Upon the expiration of a contract, the MDA would have to prepare and record a lien, if any, 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 the owner, attributable to the property formerly subject to the contract, plus interest at 6% annual simple interest rate from the time the credit was received until the lien was placed on the property.

Upon termination of a contract, the MDA would have to notify the Department of Treasury for its records.

If, upon expiration of the term of a contract, the farmland became subject to an agricultural conservation easement under Section 36206 or purchase of development rights under Section 36111b, or if a contract were terminated, the farmland would not be subject to a lien.

The unappropriated proceeds from lien payments and early withdrawal assessments would have to be forwarded to the State Treasurer for deposit in the Agricultural Preservation Fund.

Early Withdrawal Assessment

Upon written request to the MDA between January 1 and April 1, in the 10th and 15th years of the initial term of a contract, an owner could elect to terminate the contract upon payment of an early withdrawal assessment to the MDA. The early withdrawal assessment would be as follows:

-- In the 10th year, an amount equal to 7% of the true cash value subject to the contract.

-- In the 15th year, an amount equal to 5% of the true cash value of the farmland subject to the contract.

Part 361

The bill would amend the heading of Part 361, which currently is "Farmland and Open Space Preservation", to include "Development Rights Agreements and Easements".

Proposed MCL 324.36301-324.36313

Legislative Analyst: Julie Koval

FISCAL IMPACT

The bill would reduce State General Fund revenue by between $31.9 million and $42.6 million, depending on whether property taxes on buildings and structures would be eligible for the credit. The fiscal impact assumes near-100% participation for farmland not already enrolled under Part 361 (also called Public Act 116) and located in the 20 counties that either have or are considering the necessary land use plan. If more counties adopted such plans, the fiscal impact of the bill could increase significantly, to between $71.3 million and $95.1 million, depending on whether property taxes on buildings could be counted toward the credit.

The bill would have no fiscal impact on local government.

The fiscal analysis is preliminary and will be revised as new information becomes available.

Fiscal Analyst: David Zin