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BILL ANALYSIS

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Senate Bill 917 (Substitute S-2 as passed by the Senate)
House Bill 5454 (Substitute S-1 as passed by the Senate)
House Bill 5455 (Substitute S-1 as passed by the Senate)
Sponsor: Senator Shirley Johnson (S.B. 917)
Representative Kevin Elsenheimer (H.B. 5454)
Representative Bill Huizenga (H.B. 5455)
House Committee: Conservation, Forestry, and Outdoor Recreation
Senate Committee: Agriculture, Forestry and Tourism

Date Completed: 8-18-06

RATIONALE

Of Michigan's 19.0 million acres of forestland, about 2.2 million acres are registered as commercial forest under Part 511 (Commercial Forestland) of the Natural Resources and Environmental Protection Act (NREPA). Under that part, commercial forest is subject to a specific tax of $1.10 per acre, rather than the ad valorem property tax. Part 511 requires that in 2006 and every 10 years after that, the tax rate for commercial forestland be adjusted according to the State equalized value of timber cutover lands. These provisions and others have not been amended since they were incorporated into NREPA in 1995. Some believe that the provisions for calculating the tax rate, along with other aspects of Part 511, should be updated.

In addition, some have suggested that specific provisions should allow for a conservation easement on commercial forestland. Under Part 21 (General Real Estate Powers) of NREPA, a conservation easement requires and prohibits certain actions with respect to the land for the purpose of maintaining it in its natural state; or maintaining the land for agricultural, farming, open space, or forest use, or other similar uses. A conservation easement may be acquired by the State, a charitable organization, a corporation, a trust, or another legal entity, which is then responsible for administering and ensuring compliance with the terms of the easement. The easement remains with the land in perpetuity, regardless of any change in ownership. In some cases, easements have been donated to the State to ensure that an owner's wishes were carried out into the future, or to protect land from development. In other cases, the State has purchased easements to protect ecologically sensitive land or to preserve natural areas of the State. Currently, land under a conservation easement does not receive any specific tax exemption, although assessors do consider the terms of the easement in determining the taxable value of the land. According to the State Tax Commission, the cash value of the property is assessed according to its highest and best use, given the restrictions placed on it by the easement. Some believe that commercial forestland under a conservation easement should be subject to a reduced specific tax, instead.

CONTENT

Senate Bill 917 (S-2) would add Part 512 (Sustainable Forestry Conservation Easement Tax Incentives) to NREPA, to establish an annual specific tax for commercial forestland subject to a sustainable forest conservation easement, which would be 15 cents per acre less than the specific tax under Part 511 (Commercial Forests); and to require the owner to pay a penalty if forestland subject to an easement were used in violation of Part 512 or the easement.

House Bills 5454 (S-1) and 5455 (S-1) would amend Part 511 of the NREPA to do the following:

-- Increase the specific tax rate on commercial forestland from $1.10 per acre to $1.20 per acre on January 1, 2007, until December 31, 2011, and by five cents per acre on January 1, 2012, and every five years after that date.
-- Revise the current application fee of $1 per acre for a commercial forest classification to include a minimum fee of $200.
-- Establish a minimum size of 40 contiguous acres, or a survey unit consisting of 1/4 of 1/4 of a section of forestland, for land to be classified as commercial forest.
-- Specify that the privilege of hunting and fishing could not be denied for any portion of commercial forestland, even if portions of it were contiguous only at one point.
-- Require the Department of Natural Resources (DNR) to spend money in the Commercial Forest Fund for the administration and enforcement of Part 511 (as currently required) and proposed Part 512.
-- Require the DNR to notify each county and township and all owners of commercial forestland of the amendments to Part 511 made by the bills.
-- Repeal Section 51107 of the Act, which requires the tax rate for commercial forestland to be adjusted in 2006 and every 10th year after that.

House Bills 5454 (S-1) and 5455 (S-1) are tie-barred to each other and to Senate Bill 917. House Bill 5454 (S-1) also is tie-barred to Senate Bill 912 (which would exempt qualified forest property from taxes levied by local school districts).

The bills are described in detail below.

Senate Bill 917 (S-2)

Under the bill, an owner of commercial forestland that was subject to a sustainable forest conservation easement would be subject to an annual specific tax equal to the specific tax under Section 51105, less 15 cents per acre. (Please see House Bill 5454 (S-1) for a description of Section 51105.) The tax would have to be administered, collected, and distributed in the same manner as the specific tax levied under that section.

An application for the sustainable forest conservation easement tax rate would have to be submitted on a form prescribed by the Department of Natural Resources and would have to be postmarked and delivered to the DNR by April 1 to be eligible for approval for the following tax year.

The application would have to include any information reasonably required by the DNR; a copy of the conservation easement covering the forestland; and a nonrefundable application fee of $2 per acre or fraction of an acre, but not less than $200 and not more than $1,000. The DNR would have to remit the application fee to the State Treasurer for deposit into the Commercial Forest Fund.

The owner of commercial forestland subject to a sustainable forest conservation easement would be entitled to cut or remove forest products on his or her commercial forestland if the owner complied with Part 511 and the requirements of the easement.

If commercial forestland subject to a sustainable forest conservation easement were used in violation of Part 512 or the easement, the owner, in addition to any other penalties provided by law, would have to pay a penalty per acre for each year in which the violation occurred equal to the difference between the specific tax paid under Part 512 and the specific tax that otherwise would be paid under Part 511.

The specific tax collected under Part 512 would have to be paid to the treasurer of the township where the commercial forestland was located. The treasurer would have to distribute the penalty in the same manner as the specific tax would be distributed.

"Sustainable forest conservation easement" would mean a conservation easement (described in Section 2140) on commercial forestland that meets all of the following requirements:

-- Is an easement granted in perpetuity to the State, a political subdivision of the State, or a charitable organization

described in Section 501(c)(3) of the Internal Revenue Code, that also meets the requirements of Section 170(h)(3) of the Code (which defines "qualified organization" for the purpose of a "qualified conservation contribution" deduction).
-- Covers commercial forestland of 40 or more acres in size.
-- Provides that the forestland subject to the conservation easement or the manager of that land is and continues to be certified under a sustainable forestry certification program that uses independent third party auditors and is recognized by the DNR.
-- Provides that the forestland subject to the conservation easement provides for the nonmotorized use of the forestland by members of the public.

(Section 2140 defines "conservation easement" as an interest in land or a body of water that provides limitations on its use or requires or prohibits certain acts on or with respect to the land or body of water, and that is appropriate to retaining or maintaining the land or body of water predominantly in its natural, scenic, or open condition, or in an agricultural, farming, open space, or forest use, or similar use or condition.)

House Bill 5454 (S-1)

Tax Rate for Commercial Forests

Part 511 allows the owner of forestland to apply to the DNR to have that land determined to be a commercial forest. Commercial forests are not subject to the ad valorem general property tax, but instead are subject to an annual specific tax of $1.10 per acre, as adjusted by Section 51107, which requires the tax rate to be adjusted in 2006 and every 10 years after that based on the State equalized value of timber cutover land in the State.

Under the bill, the tax rate would be $1.10 per acre until December 31, 2006. Beginning January 1, 2007, through December 31, 2011, the rate would be $1.20 per acre. Beginning January 1, 2012, and every five years after that date, the tax rate would have to be increased by five cents per acre.

The tax received under those provisions would have to be distributed in the same manner and proportion as ad valorem taxes collected under the General Property Tax Act are distributed, as is currently required.

The bill would repeal Section 51107.

Withdrawal Penalty

Under Part 511, an owner of a commercial forest may withdraw his or her land, in whole or in part, from the operation of the part upon application to the DNR and payment of a withdrawal application fee and penalty. The penalty per acre is equal to the product of the current average ad valorem property tax per acre on timber cutover real property within the township where the commercial forestland is located multiplied by the number of years, up to 15, that the land was subject to Part 511.

If the township where the commercial forestland is located does not contain any timber cutover real property, then the per-acre average of the ad valorem property tax for all timber cutover real property in the county must be used in calculating the penalty. If no timber cutover real property is located in the county, the per-acre average of the ad valorem property tax for all timber cutover real property in townships contiguous to the country where the commercial forestland is located must be used.

The bill would remove these provisions. Under the bill, the penalty would be calculated by multiplying the number of withdrawn acres of commercial forestland by the average value per acre for comparable property acquired after December 31, 2004, under Subpart 14 of Part 21 (dealing with payments in lieu of taxes (PILTs) for certain State-owned land); multiplying the product of that calculation by the total millage rate levied by all taxing units in the local tax collecting unit in which the property was located; and multiplying that product by the number of years, up to seven, in which the withdrawn property had been designated as commercial forestland.

(Subpart 14 of Part 21 requires the State Tax Commission each year to determine the valuation of all real property owned by the State and controlled by the DNR, and to authorize the State Treasurer to transfer

PILTs to local units of government based on those valuations.)

For one year after the bill's effective date, an owner of commercial forestland would not be subject to a withdrawal penalty if all of the following occurred:

-- An owner of commercial forestland withdrew his or her land from the operation of Part 511.
-- The former commercial forestland was placed on the assessment roll in the local tax collecting unit in which it was located.
-- The owner of the former commercial forestland claimed and was granted an exemption from the tax levied by a local school district for school operating purposes.

In all other cases, for one year after the bill's effective date, the penalty would be the same as the withdrawal penalty that was in effect immediately before the bill's effective date.

Declassification of Commercial Forestland

Part 511 permits the DNR, upon notice to the owner and after a hearing, to declassify all or a portion of a commercial forest if an owner uses it in violation of the part; fails to pay any specific tax; fails to report to the DNR before harvesting, cutting, or removing forest products from the commercial forest; removes minerals in violation of the part; or, after certifying that a forest management plan has been prepared and is in effect, fails to plant, harvest, or remove forest products in compliance with the plan. The DNR must declassify the commercial forest if, at the hearing, the Department determines that one of those violations was committed.

Under the bill, the DNR would be required to remove the commercial forest designation for a commercial forest (rather than declassify it) if, after providing notice and an opportunity for a hearing, the Department determined that one of the violations currently listed had occurred.

House Bill 5455 (S-1)

Minimum Size of Commercial Forestland

As noted above, Part 511 allows the owner of forestland within the State to apply to the DNR to have that land designated a commercial forest. Under the bill, the forestland would have to consist of at least 40 contiguous acres or a survey unit consisting of one quarter of one quarter of a section of forestland. (A section of land is one square mile, or 640 acres.)

"Contiguous" would mean land that touched at any point. Even if portions of commercial forestland were contiguous only at a point, the privilege of hunting and fishing could not be denied for any portion of the land. The existence of a road, railroad, or utility right-of-way that separated any part of the land would not make the land noncontiguous.

Application Process

The bill would require an application for classification as commercial forest to be postmarked or delivered by April 1 to be eligible for approval as commercial forest for the following tax year. Under Part 511, the applicant must pay an application fee of $1 per acre, not to exceed $1,000. The bill also would establish a minimum fee of $200.

Other Provisions

Part 511 provides for the creation of the Commercial Forest Fund, which is to be used for enforcement, administration, and monitoring of compliance with Part 511 and rules promulgated under it. Under the bill, the Fund's uses also would include enforcement, administration, and monitoring of compliance with proposed Part 512.

Part 511 specifies that upon application to and approval by the DNR, deposits of oil and gas owned by the State may be removed from the commercial forest, without affecting the land's status as a commercial forest. The bill would refer to deposits of oil and gas, rather than those owned by the State.

Within three months of the bill's effective date, the DNR would have to notify each county and township and all owners of commercial forestland of the amendments to Part 511 enacted in 2006.

Proposed MCL 324.51201 (S.B. 917)
MCL 324.51105 et al. (H.B. 5454)
324.51101 et al. (H.B. 5455)

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

Unless amended, Part 511 will require the specific tax for commercial forestland to be recalculated before the end of 2006 based on the State equalized value of timber cutover land within the State. This requirement is unworkable, however, because complete information on timber cutover land values is not available. House Bill 5454 (S-1) would replace that provision with a simpler, more predictable formula that would require periodic increases of a set amount, so owners of commercial forestland would know in advance precisely what their future tax liability would be. Because managing forestland is a long-term enterprise in which decades may pass before owners receive a return on their investment, stability and transparency in the tax structure are important, to allow owners to make informed business decisions. The small, predictable increases specified in the bill would remove the current uncertainty over the tax rate, and could encourage more landowners to enter the program.

Under current law, the penalty for withdrawal of commercial forestland also is calculated based on the value of timber cutover land in the county in which the commercial forestland is located. If there is no timber cutover property in the county, the penalty must be calculated based on the value of timber cutover property in the surrounding counties. This is a very cumbersome process, and as noted above, the required data are not always available. House Bill 5454 (S-1) instead would base the penalty on the average value of certain comparable State-owned land. Since those data already are being collected and are readily available, the bill's provisions would be easier to implement than the current requirements are, simplifying the administration of the program.

Supporting Argument

The bills would ensure that commercial forests were open to recreational users. Historically, owners of commercial forestland in the State have been expected to allow public use of their land, in return for the substantial tax breaks they receive. In practice, however, some commercial forestland has been inaccessible for various reasons. In some instances, owners may have sold off the surrounding land, leaving no way for the public to get to the commercial land without either trespassing or flying in. In other cases, no information on access points is made available to the public. Under House Bill 5455 (S-1), the privilege of hunting and fishing could not be denied for any portion of commercial forestland, even if portions of the land were contiguous only at a point, and under Senate Bill 917 (S-2), a sustainable forest conservation easement would have to provide for public access to the land. The provisions would ensure greater public access to the land.

Response: Previous versions of the bills included much stronger language to protect public access, requiring landowners to provide information to the DNR on access points, and allowing the DNR to declassify commercial forestland if an owner failed to provide access. Those provisions would have required greater accountability for individual landowners, some of whom reportedly have not complied with the current requirements to provide access. As presently written, the bills would offer much weaker protections for recreational users, and provide no penalties for owners who failed to allow access. In addition, although the bills would require landowners to allow public use of the land, there are no provisions specifying what type of access would have to be provided. If a parcel of land is accessible only by helicopter, for example, the majority of the public will be unable to use the land. The bills should require that the public have reasonable access at clearly marked access points.

Supporting Argument

Senate Bill 917 (S-2) would establish a reduced specific tax for commercial forestland under a conservation easement, simplifying the calculation of taxes on such land and encouraging more landowners to enter into such easements. Conservation easements have proven to be a valuable way to ensure the sustainable management of private forestland, and to protect environmentally valuable property from development or ecological damage. The sustainable forest conservation easements established under the bill would ensure that the forestland was managed responsibly in perpetuity, while permitting the landowners

to harvest forest products in a manner consistent with the terms of the easement and with Part 511. These provisions would allow the forestland to serve both the public interest and the commercial interest of the landowners.

Opposing Argument

The tax rate on commercial forestland has not increased in 12 years, although during that time, timber and land values have increased substantially. House Bill 5454 (S-1) would replace currently required increases with smaller rate hikes that do not represent actual land values or timber values. The tax rate should reflect the underlying value of the property, rather than being subject to arbitrary increases every five years. A fairer mechanism would be to adjust the tax rate annually according to timber prices. Under that method, the taxes owed would rise and fall with the actual value being generated by the land. This could be done in a way that was transparent and predictable, so landowners would know their tax liability in advance. Such a method also would be easy to administer, since timber values are well known.

The bill also would provide for no increase in PILTs to local governments, which currently receive only $1.20 per acre for commercial forestland. That amount has not increased in a number of years, despite the tremendous growth in property values in some areas. Local governments have been squeezed by losses in revenue sharing from the State, and they deserve to see an increase in their PILTs to reflect more accurately lost property tax revenue.

In addition, the penalty provisions in House Bill 5454 (S-1) would not be sufficiently stiff to deter to those who might abuse the program. Unscrupulous landowners could designate land as commercial forest to receive the tax break and then later withdraw the land for development or for other purposes. The penalty should be increased to remove any economic incentive for such abuse.

Opposing Argument

House Bill 5454 (S-1) would require all commercial forestland to be accessible to the public for hunting and fishing, but in some cases, that may not be possible. As property has changed hands, access to some parcels has been limited, or may have been negotiated on an informal basis as individuals have been allowed to cross private land. Commercial forest owners have no control over the actions of other landowners in the surrounding area, and cannot guarantee that hunters and fishers will always be allowed to enter commercial forest via adjacent private land. Purchasing easements on surrounding land could be expensive and would negate the economic benefits of entering the program, and in some cases could be impossible. Because of these difficulties, landowners with forestland currently in the program should be grandfathered in, and not required to meet the access requirements of the bills.

Legislative Analyst: Curtis Walker

FISCAL IMPACT

Senate Bill 917 (S-2)

The Commercial Forest Fund would receive the application revenue. The revenue collected would depend on the size of the parcel subject to the easement. Each fee collected would be between $200 and $1,000. This would be one-time revenue collected by the State.

There are approximately 2,209,700 acres classified as commercial forestland in Michigan. It is unknown how many acres would be subject to a sustainable forest conservation easement since the designation would be at the choice of the forestland owner. If all of the commercial forestland were subject to the easement, township treasurers would collect 95 cents per acre, for $2,309,137 in revenue, which would be distributed in the same manner as ad valorem general property taxes.

If commercial forestland subject to a sustainable forest conservation easement were used in violation of proposed Part 512, the owner would owe to townships a penalty, per acre, for each year of the violation equal to the difference between what was paid under this part and under Part 511, which is $1.10 per acre of commercial forestland. Revenue would depend on the number of violations, the size of forestland, and the duration of the violations.

House Bills 5454 (S-1) and 5455 (S-1)

House Bill 5455 (S-1) would set a minimum of $200 for the commercial forest classification application fee, which would increase revenue to the Commercial Forest Fund by an undetermined amount. Applications regarding forestland of 199 acres or less would have to be accompanied by a minimum fee of $200 instead of using the rate of $1 per acre to calculate the fee. The Commercial Forest Fund receives annual revenue of approximately $35,000 and statute designates its use for enforcement, administration, and monitoring of compliance with Part 511 (Commercial Forests) of the Natural Resources and Environmental Protection Act.

House Bill 5454 (S-1) would revise the withdrawal penalty paid to local units of government by commercial forest owners. The revised formula could result in more or less revenue depending on how long the forestland had been in the program and the number of timber cutover acres that would be applied to the calculation under the current formula.

The bill would postpone implementation of these proposed changes to the withdrawal penalties until one year after the bill took ffect. During that year, current owners of commercial forests would be allowed to withdraw from a commercial forest designation without paying the penalty if they met certain criteria. The suspension of the withdrawal penalty could encourage commercial forest owners to withdraw, resulting in an indeterminate loss of revenue to local units of government and the Commercial Forest Fund.

The bills would revise the scheduled increase in payments in lieu of taxes for commercial forestland. In FY 2005-06, there were 2,209,700 acres of commercial forestland, for which the Department of Natural Resources paid $1.20 per acre for a total of $2,651,600 and commercial foresters paid $1.10 per acre for a total of $2,430,670. All of this revenue went to local units of government. Under Section 51107, these amounts will increase by about 300% in FY 2006-07. The bills propose a different formula to increase the payments. Through December 31, 2011, payments made by commercial foresters would increase by 10 cents to $1.20. The total payment would increase by about $220,970 annually with the revenue going to local units of government.

Beginning on January 1, 2012, the payments made by both the State and commercial foresters would increase by 5 cents every year. In 2012, local units of government would collect $2.50 per acre of commercial forestland, which would be $1.25 each from the two paying parties. The annual increase would be approximately $110,485 each from the State and commercial foresters. The total annual increase in revenue of $220,970 would go to local units of government. Under the bills, the payments in lieu of taxes on commercial forestland paid by the State and commercial foresters would increase, but at a slower rate than is currently established in statute.

Fiscal Analyst: Jessica Runnels

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