Senate Fiscal Agency
P.O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bill 697 (as introduced 10-21-21)
Sponsor: Senator Kimberly LaSata
Committee: Finance

Date Completed: 3-8-22

CONTENT

The bill would amend Part 1 of the Income Tax Act to do the following:

- **Allow, beginning with the 2022 tax year and extending through the 2026 tax year, a taxpayer who was an owner of agricultural assets to claim a credit against the individual income tax for the sale or rental of agricultural assets to a beginning farmer.**
- **Prohibit a taxpayer from claiming the credit unless the Department of Treasury, in consultation with the Michigan Department of Agriculture and Rural Development (MDARD), issued a certificate to the taxpayer and prescribe the information that would have to be included in a certificate.**
- **Specify that the credit would be nonrefundable but could be carried forward to offset a subsequent year's tax liability for up to five years or until it was used up, whichever occurred first.**
- **Require, beginning February 1, 2024, and each February 1 through 2028, the Department, in consultation with MDARD, to submit an annual report to the Legislature concerning the operation and effectiveness of the beginning farmer credit.**

Definitions

"Owner of agricultural assets" would mean an individual, trust, or flow-through entity that is the owner in fee of agricultural land or has legal title to any other agricultural asset. The term would not mean an equipment dealer, livestock dealer, or comparable entity that was engaged in the business of selling agricultural assets for profit and that was not engaged in farming as its primary business activity. An owner of agricultural assets approved and certified by MDARD under the bill would have to notify MDARD if the owner no longer met this definition within the tax year. "Agricultural assets" would mean agricultural land, livestock, facilities, buildings, and machinery used for farming in Michigan. "Farming" would mean the active use, management, and operation of real and personal property for the production of a farm product. "Farm product" would mean plants and animals useful to humans and includes forage and sod crops, oilseeds, grain and feed crops, dairy and dairy products, poultry and poultry products, livestock, fruits, and vegetables.

"Beginning farmer" would mean an individual who satisfies each of the following: a) is a Michigan resident, b) is seeking entry, or has entered within the last 10 years, into farming, c) intends to farm land located within the borders of Michigan, d) is not a family member of the owner of the agricultural assets from whom the beginning farmer is seeking to purchase or rent agricultural assets, e) is not a family member of a partner, member, shareholder, or trustee of the owner of agricultural assets from whom the beginning farmer is seeking to purchase or rent agricultural assets, f) has a net worth that does not exceed $800,000 (which would have to be adjusted annually for inflation), g) provides the majority of the day-to-day physical labor and management of the farm, h) has, as determined by MDARD, adequate farming experience or demonstrates knowledge in the type of farming for which the beginning farmer seeks assistance, i) demonstrates to MDARD a profit potential by submitting projected earnings statements, j) asserts to the satisfaction of MDARD that farming will be a significant source of income for the beginning farmer, and k) has other qualifications as specified by MDARD.

Income Tax Credit

Part 1 of the Income Tax Act, for receiving, earning, or otherwise acquiring income from any source whatsoever, there is levied and imposed on the taxable income of every person other than a corporation a tax at the rate of 4.25%. This is referred to as the 'individual income tax'.

Under the bill, for tax years that begin on and after January 1, 2022, and before January 1, 2027, a taxpayer who was an owner of agricultural assets could claim a credit against the individual income tax for the sale of agricultural assets to a beginning farmer for the rental of agricultural assets under a qualified rental agreement or share rent agreement to a beginning farmer equal to the amount certified each year by the Department, in consultation with MDARD, as follows:

-- For the sale of an agricultural asset, 5.0% of the lesser of the sale price or the fair market value of the agricultural asset, up to a maximum of $32,000.
-- For a qualified rental agreement of an agricultural asset, 10.0% of the gross rental income in each of the first, second, and third years of a rental agreement, up to a maximum of $7,000 per year.
-- For a share rent agreement of an agricultural asset, 15.0% of the cash equivalent of the gross rental income in each of the first, second, and third years of a share rent agreement, up to a maximum of $10,000 per year.

("Qualified rental agreement" would mean a cash rental agreement for agricultural assets that are rented at prevailing community rates as determined by the department of agriculture and rural development. "Share rent agreement" would mean a rental agreement in which the principal consideration given to the owner of agricultural assets is a predetermined portion of the production of farm products produced from the rented agricultural assets and that provides for sharing production costs or risk of loss, or both.)

A taxpayer could not claim the credit unless the Department, in consultation with MDARD, had issued a certificate to the taxpayer. The taxpayer would have to attach the certificate to the individual income tax return on which the credit was claimed. The certificate would have to state the following:

-- That the taxpayer was an owner of an agricultural asset.
-- That the recipient of the agricultural asset was certified by MDARD as a beginning farmer.
-- The credit amount for the owner of the agricultural asset for the designated tax year.
-- The taxpayer's Federal employer identification number or the Department number assigned to the taxpayer.

The total of all credits approved under the bill could not exceed $5.0 million per calendar year; however, if the Department, in consultation with MDARD, approved a total of all beginning farmer credits of less than $5.0 million in a calendar year, the Department, in consultation with MDARD, could carry forward for one year only the difference between $5.0 million and the total of all approved credits in the immediately preceding calendar year or $1.0 million, whichever was less.

If the credit exceeded the taxpayer's tax liability for a given tax year, the excess could not be refunded, but could be carried forward to offset a subsequent year's tax liability for up to five years or until it was used up, whichever occurred first.

If an owner of agricultural assets or beginning farmer terminated a qualified rental agreement or a share rent agreement, without reasonable cause as determined by MDARD, then the amount of any credits claimed based on rental income that was not received because of the agreement's termination would have to be added back to the taxpayer's tax liability in the year of the termination.

<u>Required Report</u>

Beginning February 1, 2024, and each February 1 through 2028, the Department, in consultation with MDARD, would have to submit an annual report to the chairperson of the Senate Finance Committee and Senate Agriculture Committee, the chairperson of the House Tax Policy Committee and House Agriculture Committee, and the Directors of the Senate and House Fiscal Agency concerning the operation and effectiveness of the beginning farmer credit. The report would have to include background information on beginning farmers in Michigan and any other information relevant to evaluating the effect of the credits on increasing opportunities for the number of beginning farmers. The report also would have to include all of the following:

-- The number, amount, and geographic distribution of credits issued.
-- The type of agricultural assets for which credits were issued.
-- The number and geographic distribution of beginning farmers whose purchase or rental of assets resulted in credits for the seller or owner of the asset.
-- The number of beginning farmers by geographic region in each calendar year.
-- The number and amount of credit applications that exceeded the allocation available each year.

Proposed MCL 206.279 Legislative Analyst: Jeff Mann

<u>FISCAL IMPACT</u>

The bill would reduce State General Fund revenue in fiscal year (FY) 2022-23 through FY 2027-28 by an average of approximately $5.0 million per year, although the bill's carry-forward would result in some revenue reductions occurring through FY 2032-33. Based on the experience of other states with similar credits, approximately 50-60% of the credits are fully claimed in the first year, and within three years more than 80% of the credits are claimed. As a result, total credits claimed during FY 2022-23 likely would be less than $5.0 million, and credits likely would be claimed through FY 2032-33. Because the $5.0 million limit would apply to the value of credits awarded during a fiscal year and not the amount, inclusive of carry-forwards, that can be claimed on tax returns, it is possible that from FY 2023-24 through FY 2026-27 (the last fiscal year in which a credit could be awarded), the revenue reduction in any given year would exceed $5.0 million per year.

Based on the experience of other states with similar credits, a single asset-owning taxpayer could claim multiple credits from multiple eligible transactions. Unlike some other state programs, the bill would not place any limit on the amount of credits an individual taxpayer could claim, nor would it prevent a taxpayer from claiming multiple credits from different individual transactions with the same beginning farmer. Depending on the rules issued by MDARD regarding what would constitute a "reasonable cause" to end an agreement, the bill could allow taxpayers to continue to claim credits for a transaction even if the beginning farmer ceased the eligible activities under the bill. The applicability of any claw-back amounts would depend on the definition of "reasonable cause" and apply only to rental agreements and rent share agreements. Other transactions eligible for the credit, such as sales, would not be subject to any claw-back conditions and taxpayers would be able to claim the credit regardless of the success or failure of any beginning farmer activities by the buyers.

Tax credits under the bill would be available only to existing owners of agricultural assets. The bill would not provide tax credits to beginning farmers who purchased or entered into rental, lease, or share rent agreements with the owner of an agricultural asset.

Fiscal Analyst: David Zin

SAS\S2122\s697sa