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## TAX FARMLAND BASED ON AGRICULTURAL USE VALUE

**House Joint Resolution R (Substitute H-1)**  
**Sponsor: Rep. Judson Gilbert II**

**House Bill 5779 as introduced**  
**Sponsor: Rep. Michael Green**

**House Bill 5780 (Substitute H-1)**  
**Sponsor: Rep. Jim Howell**

**Committee: Agriculture and Resource  
Management**

**First Analysis (5-23-00)**

### ***THE APPARENT PROBLEM:***

There is a longstanding -- and ever increasing -- concern in some quarters over the loss of farmland in Michigan, and an interrelated concern about the steady conversion of farmland and other open spaces to new residential, commercial, and industrial uses. The state loses 75,000 acres of farmland each year and has lost over one million acres over the past 15 years, according to the Michigan Land Use Institute. The state lost over 1,000 farmers in the 1990's. Sometimes this issue is subsumed under the general problem of "urban sprawl", which connotes the exodus of residents and businesses from already developed and populated communities to neighboring undeveloped rural areas. From the point of view of farmers and other owners of agricultural property, the issue is better understood as stemming from the low profits associated with agricultural production and the way in which high property values and high property taxes make it that much harder for them to stay on the farm and so increase the pressure to sell land for development.

This is not a new problem: the state enacted a Farmland and Open Space Preservation Act in 1974, over a quarter of a century ago, to provide tax benefits to farmers who promise not to develop their land. Yet it persists and takes on new features over time. Reportedly, farming in Michigan is in serious difficulty today. Farmers are receiving the lowest prices for their products since the Depression, according to a report from the Senate Agricultural Preservation Task Force. And the state's farmers pay some of the highest property taxes in the nation, double the national average, according to one knowledgeable source. One

problem is that agricultural land is taxed based on its market value, and in areas where residential and commercial development are nearby, the market value is the land's value as developable land and not as farmland. This leads to higher taxes than would otherwise be the case. Reportedly, only two other states tax farmland this way; the rest tax farmland based on its agricultural use. Another problem stems from Proposal A of 1994, which put in place the state's new school financing system. While Proposal A cut taxes for farmers substantially, it also reduced the benefits of being in the farmland preservation program. Proposal A also established an assessment cap, whereby a parcel's assessment cannot increase from one year to the next by more than five percent or the rate of inflation, whichever is lower. This also has benefitted farmers, but the assessment cap comes off when property is transferred, and the taxable value of property then "pops up" to be based on market values. This means, for example, a young farmer buying agricultural land from a retiring farmer faces a dramatic leap in property values, and taxes, just as he or she begins operations.

In his state of the state address in January of this year, Governor Engler endorsed a recommendation from the September 1999 report of the Senate Agricultural Preservation Task Force that agricultural land be based on its current (agricultural) use and not on its so-called highest and best use (as developable land). The governor's proposed budget for fiscal year 2001 anticipated the loss of revenues from such a change.

House Joint Resolution R and House Bills 5779 and 5780 (5-23-00)

Legislation to implement this and other farmland preservation recommendations has been developed.

### ***THE CONTENT OF THE BILLS AND THE JOINT RESOLUTION:***

The proposed legislation, in brief, would:

- Require agricultural property to be assessed based on agricultural use value rather than true cash value (or market value), beginning with taxes levied in 2001;
- Prevent the assessment cap (which limits how much a parcel's assessment can increase from year to year) from being lifted when agricultural property was sold, if the land was to continue to be used for agriculture;
- Anticipate the enactment of a "recapture tax" on agricultural property converted to a non-agricultural use, which would recapture some portion of the benefits provided by preferential taxation on agriculture (although no such recapture is part of the bills currently before the House);
- Create an Agricultural Preservation Fund in the state treasury to be used to provide grants to local units of government for the purchase of agricultural development easements (development rights);
- Transfer, as of October 1, 2000, unexpended money from lien payments under the Farmland and Open Space Preservation Act (now absorbed into the Natural Resources and Environmental Protection Act or NREPA, as Part 361) to the new Agricultural Preservation Fund and, as of that date, forward all proceeds from new lien payments under that program to the state treasurer for deposit in that fund;
- Make the Department of Agriculture rather than the Department of Natural Resources the state land use agency for the purpose of administering the development rights program in Part 361 of the NREPA.
- Exempt a greenhouse, but not the land on which it was located, and all flowering, nursery, or vegetable plants in the green house from the property tax;
- Exempt residential development property from local school operating taxes to the same extent homestead property is exempt.

Further information on the proposed legislation follows.

House Joint Resolution "R" would amend Article IX, Section 3 of the State Constitution to require the legislature to provide for an assessment system for qualified agricultural property based on agricultural use value, beginning with taxes levied in 2001. This would be an exception to the current constitutional requirement that the legislature provide for the "uniform general ad valorem taxation of real and personal property" (except for school operating taxes), and the requirement that property be assessed at 50 percent of true cash value, subject to a limitation on increases in assessments.

The resolution also would allow the legislature to provide for alternative methods of taxation for property removed from agricultural use. It would also specify that the assessment cap, which limits how much the taxable value of each parcel of property can increase from year to year, would be lifted when property assessed based on agricultural use value was removed from agricultural use (and not simply because ownership of the property was transferred, as is the case with other property). The cap limits the increase in taxable value from year to year to the increase in the general price level (the rate of inflation) or 5 percent, whichever is lower.

The resolution would be submitted to the voters at the next general election. House Joint Resolution R is not tie-barred to the bills that follow. However, the two House bills are tie-barred to House Joint Resolution R, to Senate Bill 1246 (the recapture tax bill), and to each other.

House Bill 5779 would amend the General Property Tax Act (MCL 211.7dd et al.) to put into statute the agricultural use value concept. The bill would provide that, beginning December 31, 2000, qualified agricultural property would be assessed at 50 percent of its agricultural use value.

The bill also would provide that when ownership of qualified agricultural property was transferred while remaining qualified agricultural property, the assessment cap would not be lifted, as is usually the case.

The term "agricultural use value" would be defined to mean that value calculated using the method determined by the State Tax Commission after consultation with the Department of Agriculture. The method would have to include: 1) evidence of the productive capability of the qualified agricultural property for agricultural use, including soil characteristics; 2) the average annual net return in the

immediately preceding five-year period for typical agricultural property in the county, discounted by an appropriate interest rate; and 3) the average rental income for typical agricultural property in the county. The term “qualified agricultural property” would mean property exempt from local school operating taxes under Section 7ee of the act.

Specifically, the bill would require that for taxes levied in 2000 and thereafter, the taxable value of each parcel of qualified agricultural property would be the lesser of:

- the parcel’s taxable value in the immediately preceding tax year, minus any losses, multiplied by the lesser of 1.05 or the inflation rate, plus all additions;
- the parcel’s current agricultural use value; and
- the taxable value the property would have had if taxable value had been determined under Section 27a (which determines how the taxable value of other kinds of property is determined).

Accordingly, the bill contains provisions that would put the notion of agricultural use value into the assessing process.

The bill would change the definition of agricultural real property found in Section 34c of the act, which delineates the various classifications of property for assessment purposes. Agricultural real property now includes parcels used partially or wholly for “agricultural operations”, and that term is defined in the act to include farming in all its branches, including cultivating soil; growing and harvesting any agricultural, horticultural, or floricultural commodity; dairying; turf and tree farming; and performing any practices of a farm incident to, or in conjunction with, farming operations. The bill would instead refer to parcels used partially or wholly for “agricultural use”.

The term “agricultural use” would refer to substantially undeveloped land devoted to 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. Agricultural use includes property enrolled in a federal acreage set-aside program or a federal conservation program. The term does not include substantially undeveloped land the primary purpose for which is the

management and harvesting of a woodlot or a commercial storage, processing, distribution, marketing, or shipping operation. (This is the definition found in the Farmland and Open Space Preservation Act.)

An owner of qualified agricultural property would have to inform a prospective buyer that if the property was ‘converted by a change in use’, it would be subject to the recapture tax provided in the Agricultural Property Recapture Act. For qualified agricultural property only, the tax statement mailed to the taxpayer or the taxpayer’s agent would have to include the recapture tax that would be imposed under the Agricultural Property Recapture Act if the property was converted by a change in use.

The bill anticipates (and is tie-barred to) the enactment of an Agricultural Property Recapture Act, which would provide for a levy of a recapture tax on qualified agricultural property that was “converted by a change in use” to property that no longer was qualified agricultural property (and no longer qualified for the exemption from school operating taxes.) This act would be created by Senate Bill 1246, which is still in the Senate. Senate Bill 1246 contains the recapture tax formula.

New Exemptions. The bill would exempt a greenhouse, but not the land on which it was located, and all flowering, nursery, or vegetable plants in the greenhouse from the property tax. The term “greenhouse” would refer to a structure or enclosure consisting of a wood, fiberglass, or metal frame with a glass, plastic, acrylic, polycarbonate, polyethylene, or similar covering, designed to regulate climatic conditions in order to germinate, grow, or store flowering, nursery, or vegetable plants.

The bill would also exempt “residential development property” from local school operating taxes to the same extent homestead property is exempt. This includes property that meets all of the following requirements: it is classified as residential real property under Section 34c; it has had a final plat recorded under the Land Division Act after the effective date of the bill or has had a condominium subdivision plan completed and a master deed for all or a portion of the real property recorded under the Condominium Act; and there is not now nor has there ever been an occupied residential dwelling unit or condominium located on the real property. The term could include property with a partially completed residential dwelling or a partially completed condominium unit, or a fully completed residential dwelling that is not and has never been

occupied. The term would not include property with a residential dwelling or condominium unit used for commercial purposes or as an office, showroom, or model. (The current definition of developmental real property in the act would be deleted.)

House Bill 5780 would amend the Natural Resources and Environmental Protection Act (MCL 324.36101 et al.) to create a new Part 362 establishing an Agricultural Preservation Fund within the state treasury. The state treasurer could receive money or other assets from any source for deposit in the fund, including gifts, bequests, and other donations. The treasurer would direct the investment of the fund and credit interest and earnings from investments to the fund. The bill would specify that expenditures of money in the fund “are consistent with the state’s interest in preserving farmland and are declared to be for an important public purpose.” Money in the fund could be spent, upon appropriation, as follows:

– Not more than \$700,000 annually for the administrative costs of the Department of Agriculture and Agricultural Preservation Fund Board. However, if deposits into the fund during any given fiscal year exceeded \$8.75 million, up to 8 percent of the deposits could be expended for administrative costs.

– After expenditures for administrative costs, money in the fund could be used to provide grants to local units of government for the purchase of agricultural conservation easements. An agricultural conservation easement would mean a conveyance, by a written instrument, in which, subject to permitted uses, the owner relinquished to the public in perpetuity his or her development rights and made a covenant running with the land not to undertake development.

— After the first two kinds of expenditures, if the amount of money remaining in the fund exceeded \$10 million, money in the fund could be used for the acquisition of development rights under Section 36111b, which deals with the purchase of development rights of “unique and critical” land areas (as well as farmland). A unique and critical land area is defined as agricultural and open space lands identified by the state land use agency as an area that should be preserved.

The department would be required to establish a grant program to provide grants to eligible local units of government for the purchase of agricultural conservation easements. A local unit would be eligible to submit a grant application if the unit 1) had adopted a development rights ordinance providing for a purchase-of-development-rights program under the

County Zoning Act, the Township Zoning Act, or the City and Village Zoning Act; and 2) had adopted within the previous 10 years a comprehensive land use plan that included a plan for agricultural preservation. The purchase-of-development-rights program would have to contain an application procedure, the criteria for a scoring system for parcel selections within the local unit of government, and a method to establish the price to be paid for development rights, which could include an appraisal, bidding, or formula-based process.

A grant application would be submitted on a form prescribed by the department and would have to include at a minimum a list of parcels proposed for acquisition of agricultural conservation easements, the size and location of each parcel, the amount of local matching funds, and the estimated acquisition value of the easements. The department would forward the applications to the Agricultural Preservation Fund board.

The Agricultural Preservation Fund board would consist of the director of the Department of Agriculture; the director of the Department of Natural Resources; and five individuals appointed by the governor. The director of the Department of Agriculture could appoint two additional members with knowledge and expertise in agriculture, land use, or local government, as nonvoting members.

An application submitted to the board would have to be evaluated according to selection criteria established by the board. The criteria would have to place a priority on the acquisition of easements on the following: farmland that had a productive capacity suited for the production of feed, food, and fiber; farmland that would complement and was part of a documented, long-range effort or plan for land preservation by the local unit of government in which it was located; farmland that was located within an area that complemented other land protection efforts by creating a block of farmland that was subject to an agricultural conservation easement under the bill or a development rights agreement under Part 361 or for which development rights had been acquired under Part 361; farmland in which the applicant or other person contributed a portion of the money for or provided other consideration toward the cost of the easement and the amount of that contribution; and other factors considered important by the board.

After reviewing grant applications, the board would determine which grants should be awarded and the amount of the grants. The board would have to notify

the department of its decisions and submit a report to the commission of agriculture. The board could establish a maximum amount per acre that could be spent using money from the fund for the purchase of easements. The department would distribute the grants to local units and would condition the receipt of a grant on the department's approval of the easements being acquired.

In reviewing permitted uses contained within an easement, the department would have to consider whether: the permitted uses adversely affected the productivity of farmland; the permitted uses materially altered or negatively affected the existing conditions or use of the land; the permitted uses resulted in a material alteration of an existing structure to a nonagricultural use; and the permitted uses conformed with all applicable federal, state, and local laws and ordinances.

The department could accept contributions of all or a portion of the development rights to one or more parcels of land as part of a transaction for the purchase of an agricultural conservation easement.

A local unit that purchased an easement with money from a grant could purchase the easement through an installment purchase agreement under terms negotiated by the local unit of government.

An easement acquired under this part would be held jointly by the state and local unit of government. However, the state could delegate enforcement authority of one or more agricultural easements to the local units. An easement acquired under this part could be transferred to the owner of the property subject to the easement if 1) the state and local unit holding the easement agreed to the transfer and the terms of the transfer; and 2) the property owner agreed to pay to the fund the fair market value of the easement as of the date of the transfer, but not less than the original purchase amount.

### ***BACKGROUND INFORMATION:***

Bills containing a similar proposal to that found in House Bill 5780 passed the House in the 1997-98 legislative session, House Bills 5894 and 5895. They would have created a Farmland Trust Fund. Also, House Bill 4616 of the 1997-98 legislative session would have exempted residential property from school operating taxes as does the current House Bill 5779. That, too, passed the House.

### ***FISCAL IMPLICATIONS:***

The House Fiscal Agency reports that House Bill 5779 would reduce property taxes by about \$95 million in calendar year 2001. Local government revenue would be reduced by \$39.7 million and local school property revenue would be reduced by \$31.6 million. The state would see a reduction in state education tax revenue of \$23.8 million. The state would also see an increase of \$15.7 million to reimburse schools for lost local property tax revenue. (HFA fiscal note dated 5-16-00)

### ***ARGUMENTS:***

#### ***For:***

The legislative package would lower the tax burden on farmers and other owners of agricultural land with the intention of helping to make farming more profitable and reducing the pressure to sell farmland for development. It would do this by assessing agricultural property based on its agricultural use value and not on its development value. That is, a farm would be valued for tax purposes as if its only use was for agricultural production and not proleptically as the site of a future residential subdivision or industrial park. Currently, property is assessed at true cash value, or market value, based, generally speaking, on its "highest and best use" (subject to the constitutional assessment cap). Farmland that is close to urban and suburban communities or near to open spaces being developed is thus assessed at the value it has to those who desire to purchase it not for its farm uses but for residential, commercial, or industrial uses. This drives up the value of agricultural land. farmland specialists say.

Since the passage of Proposal A, which created the new state school funding system, there has been an assessment cap which limits how much a parcel's assessment can increase from year to year to the rate of inflation or five percent, whichever is less. This cap is lifted when property is transferred. The assessment cap has reportedly led to dramatic differences between the taxable value of farmland and its state equalized value (based on market value). While this has kept taxes lower than they would otherwise be, it means that if a young farmer wants to purchase a farm from a retiring farmer, the assessed value of the property -- and the taxes on the property -- will "pop up" dramatically upon transfer of the land. This package of bills would eliminate the "pop-up" when land is transferred and kept in agricultural use.

#### ***Against:***

If coupled with a meaningful recapture tax, the proposed resolution and House bills could have beneficial effects on efforts to preserve farmland and

green spaces and to assist farmers in staying on the land. A recapture tax should be charged to recoup the full value of benefits from preferential taxation when agricultural property is sold and developed. Unfortunately, without a meaningful recapture tax, the package could have the opposite effect, say some preservationists, and encourage developers to purchase agricultural land because of the low holding costs created by the reduction in property taxes. The package would actually increase land speculation thanks to taxpayer-provided subsidies. Further, the new preservation fund is supposed to be funded from recapture fees (among other sources), and if the fee is minor, there will not be enough resources put into farmland protection programs. Some critics say the resolution and bills before the House should not be acted upon until the package as a whole contains a substantial recapture tax proposal. Then, the package would help farmers, protect farmland, and discourage land speculation. (One organization, the Michigan Land Use Institute, has proposed a recapture fee of 20 percent of market value phased in over four years.) Without a meaningful recapture fee, important allies in the effort to promote farming will likely oppose the ballot proposal necessary to change the constitution.

**Response:**

Some people oppose any recapture tax when agricultural property is developed. It is a matter of property rights and the ability of property owners to do what they want with their own land. It is one thing to provide assistance to farmers through tax policy, but yet another to penalize those who want to develop land to meet consumer demand for housing or to provide economic benefits through the construction of commercial and industrial facilities. If there is to be some recapture, it should be modest and the proceeds should go not to an anti-development state land acquisition fund but back to the local units who lost the tax revenue in the first place. It should go to schools, community colleges, townships, and counties.

**Against:**

Some people oppose on principle the constitutional amendment as a means of providing preferential tax treatment to agricultural property. Property owners should be treated alike, otherwise one classification of taxpayers must make up for another. For example, representatives of assessors say that it is one thing to exempt certain properties from taxes, but another entirely to discard the principle of uniformity in assessments currently in the state constitution. The switch to agricultural use value, moreover, will add administrative burdens for assessors, who will need to track both market value and use value on agricultural parcels. It should be noted that some people believe farm assessments and taxes could be lowered without a constitutional amendment, by exempting agricultural property from property taxes and substituting a specific tax.

**For:**

The Agricultural Preservation Fund Program proposed in House Bill 5780 would help protect valuable farmland by providing a payoff for farmers that will allow them to avoid selling land for development and keep land in agricultural production. The bill will allow local units of government to purchase development rights and establish conservation easements. This creates a a competitive, voluntary, financial alternative to development of farmland.

**Response:**

Some people believe the administration of the grant program should be at the county level with local involvement rather than administered at the local unit level as called for in the current version of House Bill 5780. They say this is the most successful model nationally.

**For:**

House Bill 5779 would provide much needed tax relief for residential developments while construction is underway and provide equity for homebuilders, by treating residential development property like homestead property (and exempting it from local school operating taxes). Since the passage of proposal A, homesteads typically pay only the new 6-mill state school property tax. Non-homestead property pays an 18-mill local school operating tax in addition to the state tax, for a total of 24 mills. (In some school districts, there are additional mills levied.) The new tax system makes the inequity more obvious between

completed and occupied housing and housing under construction. The bill would remedy this by treating them the same. To the extent this reduces the cost of building homes, it could lead to lower housing prices. It should be noted that platting property is expensive, complicated, and time consuming, and so would not be undertaken just for the tax benefit.

The American Farmland Trust, Central Great Lakes Region, says it is imperative a meaningful recapture be included in the package. (5-18-00)

***Against:***

Concern has been expressed that this change would offer an incentive to plat land that is non-agricultural open space, because then the property could be taxed at a lower rate. Furthermore, when voters approved Proposal A in 1994, they anticipated one rate for homestead property (owner-occupied primary residences) and another for non-homestead property. They did not anticipate homestead property tax rates for housing under construction and vacant developable land.

***POSITIONS:***

The Department of Agriculture supports the package. (5-22-00)

The Department of Treasury is in general support of the package. (5-19-00)

The Michigan Farm Bureau has indicated support for the package. (5-16-00)

The Michigan Association of Home Builders supports House Joint Resolution R and House Bill 5779 and opposes the concept of recapture. (5-19-00)

The Michigan Municipal League supports the concept of House Joint Resolution R. (5-19-00)

The Michigan Townships Association supports the concept of agricultural use value assessment. (5-19-00)

The Michigan Assessor's Association is opposed to House Joint Resolution R. (5-19-00)

The Michigan United Conservation Clubs does not support the package in its current form. (5-16-00)

The Michigan Land Institute has urged the adoption of a credible agriculture tax recapture fee. (5-15-00)

Analyst: C. Couch

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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.