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SFA**BILL ANALYSIS**

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Senate Bill 48 (Substitute S-1 as reported)
Sponsor: Senator Leon Stille
Committee: Finance

Date Completed: 11-29-99

RATIONALE

Much has been said in recent years about how agriculture has come under increasing economic pressures. To address this and other issues related to agriculture, the Senate Agriculture Preservation Task Force was created in the spring of 1999. The task force was asked to examine the condition of agriculture in Michigan and identify the challenges and threats it faces. After receiving testimony from over 250 persons, the task force produced a report on agriculture in the State. The report states that the farm sector is in the worst condition it has been in since the mid-1980s; prices for many commodities are as low as they have been in decades; few young people are entering agriculture; and economic pressures on farmers and processing industries are causing agricultural resources, including land, to be removed from farm production. The report concludes that the fundamental cause of the problems in farming is low profits, and that policies designed to address the issues facing agriculture should focus on profitability. The report lists 12 specific recommendations for State action, including reducing taxes, developing new tax credits and enhancing current credits, and protecting farms against certain State and local regulations. In regard to tax reduction, the report recommends that property taxes on farmland be based on the land's current use, and not its highest and best use.

Under Article 9, Section 3 of the State Constitution, the Legislature must provide for the determination of the true cash value of real and personal property. This process results in property assessments that are based on a determination of what a parcel would bring on the open market if sold (thus, its highest and best use), rather than on its current use. This can be particularly problematic for farmland. For instance, a farm near a fast-growing area may produce income to the farmer that is comparable to the same sized farm in another area, but because of the first farm's location, its acreage may be valued substantially higher than the second farm, and thus result in higher property taxes.

It has been pointed out that to assess farm property based upon something other than its highest and

best use would require an amendment to the State Constitution. (This has been proposed by Senate Joint Resolution M.) It has been suggested that the General Property Tax Act should be amended to implement the proposed constitutional change, should it be adopted by the voters.

CONTENT

The bill would amend the General Property Tax Act to provide that beginning December 31, 1999, property that was classified as "agricultural real property" or that was in "agricultural use" would have to be assessed at the lesser of the property's value determined under the income approach to valuation or the market approach to valuation. The bill is tie-barred to Senate Joint Resolution M, which would propose an amendment to Article 9, Section 3 of the State Constitution to require agricultural real property used in agricultural operations to be assessed based on the property's use in agricultural operations, without regard to its highest and best use. In addition, the bill would replace the term "cash value" with the term "true cash value" in the Act's definitions.

(The Act provides that in determining the true cash value of property, assessors must use the official assessors manual approved by the State Tax Commission. The assessors manual prescribes three methods of determining the value of property, including the income approach and the market approach. As provided in the assessors manual, the income approach is used in the valuation of investment property; a projection of expected gross income is prepared, the items of operating expenses are estimated, and the difference between gross income and expenses indicates the expected net income. The market approach (called the direct sales comparison approach, in the manual) estimates the value of a given property by comparing it with similar property that has recently been sold or offered for sale in the open market.)

The bill would refer to "agricultural real property" under Section 34c of the Act, which provides that

“agricultural real property” includes parcels used partially or wholly for agricultural operations, with or without buildings, and parcels assessed to the Department of Natural Resources and valued by the State Tax Commission. “Agricultural operations” means farming in all its branches, including cultivating soil; growing and harvesting any agricultural, horticultural, or floricultural commodity; dairying; raising livestock, bees, fish, fur-bearing animals, or poultry; turf and tree farming; and performing any practices on a farm incident to, or in conjunction with, farming operations. A commercial storage, processing, distribution, marketing, or shipping operation is not part of agricultural operations.

The bill provides that “agricultural use” would mean that term as defined in the Natural Resources and Environmental Protection Act. The Natural Resources and Environmental Protection Act provides that “agricultural use” means 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. The management and harvesting of a woodlot is not an agricultural use under the Act.

MCL 211.27

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

Farming remains an enormous part of the overall economy of Michigan. According to the Michigan Agriculture Statistics Service, the agricultural sector adds over \$4 billion to the State’s economy each year. Nevertheless, farmers are facing difficult times. Agricultural prices, adjusted for inflation, are at their lowest levels since the depression, according to the Agricultural Preservation Task Force report. Some food processing plants have closed or moved out-of-State. Low profitability in agricultural operations has caused many farmers to transfer their assets (land) to nonfarmers, usually developers. This has resulted in a steady reduction in the number of acres in farm production. Many people feel this will have long-term negative consequences for society in general, because it will reduce the nation’s ability to provide food for an ever-increasing population, and increase our dependence on foreign producers. By ensuring that farm property would be assessed based upon its current use, rather than its highest and best use, the

bill would reduce farmers’ property taxes and thus increase their chances of remaining profitable.

Supporting Argument

Taxes must be included in the cost of production; therefore, higher taxes result in lower profits. In the case of a farm in a developing area, an assessment based upon the land’s highest and best use may preclude future use of the land for farming; that is, when the property is transferred either by sale or to an heir, the new assessment may raise the property taxes to the point at which the new owner can no longer make a viable profit by farming the land. The logical step for the new owner, then, is to sell the land to developers for residential, commercial, or industrial use, thus removing the land from farm production. Once this happens, the property is almost never returned to farmland. The State should take steps to ensure that agriculture remains a vital part of the State’s economy, and to do that it must do what it can to help farmers. The bill would implement one of several recommendations made by the Task Force to provide substantial tax relief to farmers, and thus would help to keep farmland as farmland.

Opposing Argument

The Constitution requires the Legislature to provide for the determination of true cash value of property. The General Property Tax Act, in implementing this provision, defines cash value as the usual selling price of a property “...being the price that could be obtained for the property at private sale...”. The bill would single out agricultural property from all others in terms of determining a parcel’s true cash value, because it would require such property to be assessed according to the lesser of two approaches to valuation. This would destroy the principal of uniformity in assessments. Uniformity is an important concept, because it attempts to ensure that a property owner’s share of the taxes collected for operating the government is proportional to the value of his or her property in relation to the value of other property in the taxing unit.

Further, the bill would cause assessors to have to prepare two separate assessments for each piece of agricultural property. In rural areas, this could require a significant increase in the workload of local assessors. In addition, some people contend that the statutory provisions used to determine what is and what is not agricultural property for assessing purposes lack clarity, and that resulting interpretations by local assessors may lead to wide differences in parcels that are classified as agriculture. It has been suggested that a better alternative than the proposed bill would be to require all property to be assessed on its current use, rather

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than on highest and best use.

Response: The proposed statutory and constitutional amendments would create a specific exemption to the principal of uniformity in assessments. It must be remembered that the bill would implement changes made to the Constitution only if the voters saw fit to approve proposed amendments.

Legislative Analyst: G. Towne

FISCAL IMPACT

Based on literature and data from other states, this bill would reduce property taxes by approximately \$90 million in calendar year 2000. Local government property tax revenue would decline by \$37.6 million and school property taxes would decline by \$29.9 million. The State fiscal impact would be a reduction of the State education tax revenue by \$22.5 million and an increase of \$14.9 million to reimburse schools for lost property tax revenue. It is important to note that implementation of the existing use value for agricultural property, as indicated in this bill, could change the estimated fiscal impact.

Fiscal Analyst: R. Ross