Farmland and Open Space Preservation Act
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Public Act 116

FARMLAND AND OPEN SPACE PRESERVATION ACT

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FARMLANDS AND WILDLIFE AREAS of Michigan can now be preserved from nonfarm uses through property tax relief.

In May 1974, Public Act 116, the "Farmland and Open Space Preservation Act," was passed into state law to provide this form of protection. It covers both farmland and open space, and provides tax relief to an owner of farmland as long as the owner agrees to keep it in substantially undeveloped condition. Any owner of farmland may apply for a "farmland development rights agreement."

This bulletin discusses only the parts of Public Act 116 that pertain to agriculture.

ELIGIBLE FARMLAND

Farmland is defined as land in agricultural use for the production of plants and animals useful to man. It must be substantially undeveloped and actively farmed. "Actively farmed" means over half the land under agreement must be cultivated and/or currently used pasture. "Substantially undeveloped" means any parcel or area of land essentially unimproved except for a dwelling, building, structure, road and other improvements incidental to agricultural use.

To qualify, the farm must also meet one of three requirements: 1) 40 acres or more in size, 2) 5 acres or more but less than 40 acres with at least $200 annual gross income per acre of cleared and tillable land from agricultural production, 3) a specialty farm producing an annual gross income of $2,000 or more from agricultural use.

The land does not have to be one contiguous area. Noncontiguous parcels which are a part of the farm operation may be included. A farm with nonagricultural operations can qualify provided the application for the agreement includes a legal description of only the undeveloped portion of the farm. Only the undeveloped part will come under the agreement. The owner of more than one parcel of farmland may include all the parcels under the agreement or exclude one or more parcels.

WHAT THE ACT DOES

The agreement lasts for a term of not less than 10 years and can be renewed again for 10 years or longer periods. The agreement stays with the land and will affect subsequent owners with no penalty as long as the new owners comply with the provisions of the agreement.

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The owner pays property taxes as before, but any amount by which the tax on the farmland under agreement exceeds 7% of the owner's household income becomes a tax credit applied to the state income tax. If the credit is larger than income tax owed, the excess is refunded to the owner by direct payment.

HOUSEHOLD INCOME

Household income is the same as computed for homestead property tax relief. Begin with your income base for federal income tax purposes, and then add other income such as:

— excluded portion of capital gains
— social security
— retirement benefits, pensions, annuities, interest
— gifts in cash or kind in excess of $300
— virtually all other income.

PARTNERSHIP OR CORPORATION

If a partnership owns the land, the property taxes are allocated to the individual partners in the same proportion as the net income allocation from the partnership. Each partner applies his property tax share to his household income and obtains the tax credit on his state income tax.

In the case of farmland owned by two or more persons not in partnership, property taxes are allocated to the respective owners in proportion to the net income split from the land.

A corporation landowner is eligible for a farmland development rights agreement just like an individual or partnership. However, a corporation does not have household income as defined for an individual family unit. Therefore, prior to the passage of the Single Business Tax, a farm corporation used its taxable income in computing its credit. At this printing, corporations are now required to calculate their credit based upon the *adjusted tax base* under the Single Business Tax. This change has had the effect of substantially reducing the tax advantages initially available to farm corporations. Efforts are underway to redefine what household income means for a corporation owning farmland. It is unknown at this time whether changes will be made in the definition.

Examples of tax credit calculations for various types of land owners are shown in Table 1. Property taxes are split equally to each partner in the partnership landowner example because partnership income is allocated equally to each partner. A corporation uses the adjusted tax base under the Single Business Tax as its household income. At the present time, the SBT adjusted tax base is used for both regular tax paying and subchapter S farm corporations.

OTHER EFFECTS

Under a tax credit agreement, no structures may be built on the land except those consistent with farm operations or with the approval of the local governing body or state land use agency. Structures include: silos, barns, machine sheds, grain storage and feedlots. Land improvements are also limited to those consistent with farming or by approval, such as drain tiles and ditches, fences, fertilizing, liming and similar activities.

Land may be sold for scenic, access or utility easements which do not substantially hinder farm operations. Also, one does not have to pay special assessments which are not related to agricultural use, such as sanitary sewers, water, lights or nonfarm drainage, levied during the agreement. But the landowner cannot use them unless he pays for them. If one signs up for the development right agreement, one can still take advantage of the state homestead property tax relief.

THE DEVELOPMENT RIGHT AGREEMENT

Application

Application forms are obtained from the township board, if the township has a zoning ordinance, or from the county board of commissioners. The clerk's office will have the forms in each case.

The application includes a map showing the significant natural features and all structures and physical improvements located on the land and the soil classification, if known. The map also includes the active agricultural areas of the farm and type of use. A copy of the most recent property tax assessment notice must accompany the application, along with a statement of the County Register of Deeds certifying the names of the owners of record, the legal description of the property and all liens, covenants and other encumbrances affecting the title to the land.

Review

In the next 45 days after receiving an application, the local governing body circulates it to local and regional review bodies. The local governing body may approve or reject the application by a majority vote, and then notifies the applicant. An approved application is sent to the state land use agency for review, and approval, except in cases where the agency feels the land does not qualify as farmland.

Appeals

A rejected application must be returned to the applicant with a written statement regarding the reasons for rejection. The applicant then has 30 days to appeal to the state land use agency. The applicant can also file for an appeal if, after the set time period, the local governing body does not act either way on his application. If this fails, the applicant may reapply following a one-year waiting period.

Termination

Naturally Expiring — After 10 years or longer period, the agreement expires, and the development rights are returned to the owner without penalty or interest, unless renewed by the landowner. At this time a lien is put on the farm for the total amount of the tax credit received in the last 7 years. There is no interest payable on this lien. The lien is payable when any part of the land is sold or when the land is developed for purposes other than agriculture. If the owner renews the agreement, the lien is discharged; a subsequent lien cannot be less than the lien discharged.

Landowner Dies or Becomes Disabled — If the landowner dies or becomes totally and permanently

Table 1. Examples Showing Tax Credit Calculations

	Individual Landowner	Partnership Landowner Partner A	Partnership Landowner Partner B	Corporation Landowner
Household Income				
Net Farm Income	$12,000	$10,000	$10,000	SBT adjusted
Nonfarm Income	3,000	8,000	3,000	tax base
Household Income	$15,000	$18,000	$13,000	$20,000
Development Rights Agreement				
Household Income	$15,000	$18,000	$13,000	$20,000
Percent Multiplier	.07	.07	.07	.07
Base For Tax Credit	$ 1,050	$ 1,260	$ 910	$ 1,400
Property Taxes	$ 3,000	$ 2,000	$ 2,000	$ 3,000
Base For Tax Credit	-1,050	-1,260	-910	-1,400
Tax Credit	$ 1,950	$ 740	$ 1,090	$ 1,600

disabled during the agreement, the land may be released from the agreement and be subject to the same provision as if the agreement had naturally expired. The deceased's heirs may continue the agreement.

Public Interest — If both the state and landowner agree that development of the land is in the public interest, such as for roads or schools, the agreement will end with no penalty to the landowner. The landowner will not have to pay back any credit received.

Early Termination — If the landowner decides he no longer wants the agreement, he may apply to have the agreement relinquished. However, the sale of the land for development purposes would not be considered adequate reason to terminate the agreement. The same application procedures are used as with signing up for the agreement. If the development right is relinquished, a lien is placed against the land for the total amount of tax credit received, plus an interest rate of 6% per annum compounded from the time the credit was received until it is paid.

CASE STUDIES

To perceive the future effects of this program, the authors looked back to the 10-year period (1965-1974) to see what would have happened if this law had been in effect in 1965. Eight farms were chosen (nonrandomly) on the basis of type and location with no attempt to compare their profitability.

The farms, located in predominantly rural areas in the lower peninsula, are operated full time by an owner-operator; some, however, did rent land. (It should be noted at this point that before signing up for the agreement, the owner should calculate his own tax savings and also decide how long the land will be in agricultural use.)

Table 2 shows the results of the 10-year period for a dairy farm with 180 acres and about 70 milk cows each year.

The dairy example shows no tax credits until 1971 when household income dropped below prior years. Farm reassessment in 1972 caused property taxes to increase greatly, and tax credits resulted even during relatively high household income years.

Table 3 summarizes the data from all eight farms during the 1965-1974 period.

Even though dairy farm B had comparatively low household income, property taxes were also low and the tax credit minor. Cash grain farm A was the only case farm that did not receive a tax credit. The farmer owned only 39 acres (most of the cropland was rented) until 1973. This case combined a large household income with low property taxes, resulting in no benefit under the Act.

This table shows that if the law had been in effect, these farms would have saved, as a group, almost half their property taxes. In money terms, the average saving per farm during the 10-year period was $7,401.

Case Study Projection

Dairy farm A was used to project taxes and tax credit received into the future. The results are summarized in Figures 1-3 in the form of percent tax credit received of taxes paid. Three different percent increases (5, 10, 15%) compounded annually were used to project taxes into the future.

An example of how to calculate one's own tax increase follows. Put the percent increase (say 5%) in decimal form (.05) and add it to 1. Take the answer (1.05) and multiply it by the property tax of 1974 ($2,926) to project 1975 taxes ($3,072). Multiply the projected tax of 1975 by 1.05 to get projected 1976 tax ($3,226). One can continue the process for as many years as desired; we stopped at 1984.

Even with a household income of $30,000 by the year 1984, tax credit received would be over one-half (56%) of property taxes paid, based on a 5% increase per year, 71% at 10% increase and 82% with 15% increase per year. This shows that the faster property taxes increase, the greater the benefit by taking advantage of this law. The increase in property taxes for dairy farm A during the past 10 years was 15% per year.

Table 2. Tax Credit Calculations On Dairy Farm A For 1965 Through 1974

Year	Household Income	Property Taxes Paid	Household Income X 7%	Tax Credit
65	$ 13,100	$ 832	917	0
66	17,738	867	1,241	0
67	29,874	823	2,091	0
68	24,840	780	1,738	0
69	20,463	1,081	1,432	0
70	19,148	1,165	1,340	0
71	14,625	1,386	1,023	363
72	29,302	2,390	2,051	339
73	20,971	2,766	1,467	1,299
74	19,380	2,926	1,356	1,570
	$209,441	$15,016		$3,571

Table 3. Tax Credit Calculations on Eight Farm Cases for 1965 Through 1974

Type of Farm (No. of livestock)	Acres Owned in 1974	Household Income (1965-1974)	Property Taxes Paid (1965-1974)	Tax Credit (1965-1974)	% Tax Credit of Taxes Paid
Dairy A (70)	180	$ 209,441	$ 15,016	$ 3,571	24
Dairy B (30-50)	220	109,845	7,885	704	9
Dairy C (46-145)	690	159,009	19,892	8,934	45
Thumb-Cash Crop	325	244,653	26,755	9,780	37
Fruit	168	102,383	13,980	6,949	50
Cash Grain A	119	284,168	4,623	0	0
Cash Grain B	210	81,138	14,190	9,940	70
Beef (440-711)	407	7,050	23,266	19,385	83
		$1,180,983	$125,607	$59,213	47

Source: MSU Telfarm reports.

SUMMARY

The biggest and most important advantage of a development right agreement is the tax credit received. All but one of the eight case farms benefitted from the Act. The maximum property tax payable under this Act is 7% of household income.

Another advantage is that owners can receive full benefits of both the homestead property tax relief and the development rights agreement. However, the homestead and development rights agreement credits together may not exceed the property taxes paid on property under the development rights agreement. The average amount saved on property tax on the eight farms surveyed was 47% (Table 3).

The agreement helps farmers close to urban areas by providing tax relief in a form that does not require payment of special nonfarm type assessments levied during the agreement.

The greatest disadvantage is the inability to develop the land for nonfarm purposes during the term of the agreement. A commitment is made with the state to keep the land for agricultural purposes. This is an advantage in the long run for Michigan agriculture.

Another disadvantage is the repayment of the tax credit at 6% interest, if approval is obtained to develop the land during the agreement. But, in times of high interest rates (such as now), this provision can be an advantage, as it would be like borrowing money at 6%.

Use the worksheet to compute the tax credit for your farm during the last 10 years and/or project the tax credit for the future. Based on this analysis, you will have better information for deciding whether to apply for a development rights agreement.

GLOSSARY

Owner: — A person having a freehold estate in land coupled with possession and enjoyment. However, where land is subject to a land contract, it means the vendor (seller) in agreement with vendee (purchaser).

Person: — An individual corporation, business trust, estate, trust, partnership or association or two or more persons having a joint or common interest in the land.

Property taxes: — General *ad valorem* taxes levied after January 1, 1974, on lands and structures in this state, including collection fees, but not including special assessments, penalties, or interest. December tax bill must be used, so can't double up.

FURTHER INFORMATION

The Office of Land Use is preparing information packets for distribution to interested property owners. To receive one, write to:

Dennis A. Conway
Division of Land Resource Programs
Department of Natural Resources
Stevens T. Mason Building
Lansing, MI 48926

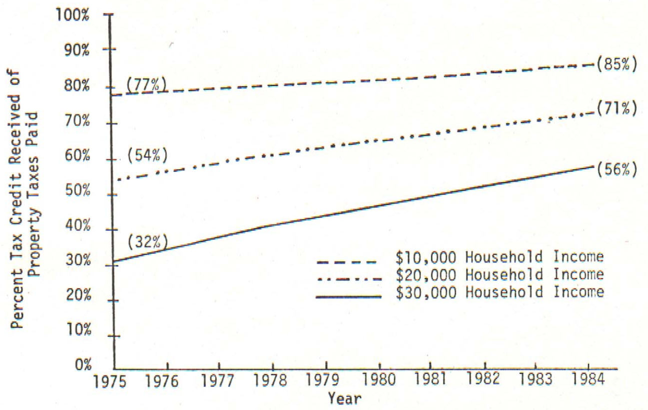

Fig. 1. Dairy Farm A Tax Credit Projection with Three Household Income Levels and a 5% Per Year Increase in Property Taxes.

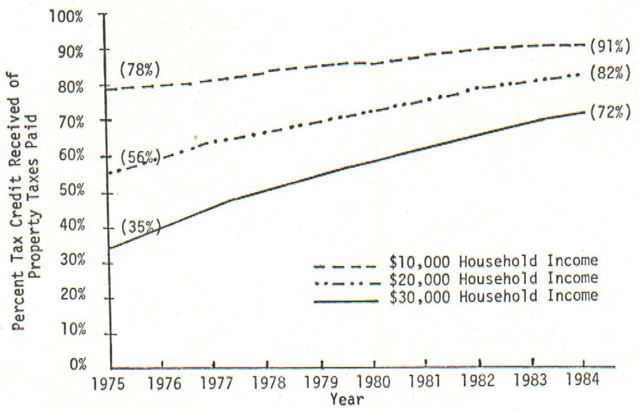

Fig. 2. Dairy Farm A Tax Credit Projection with Three Household Income Levels and a 10% Per Year Increase in Property Taxes.

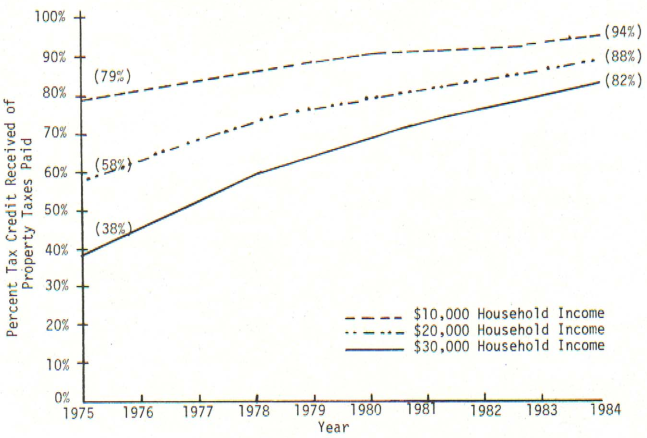

Fig. 3. Dairy Farm A Tax Credit Projection with Three Household Income Levels and a 15% Per Year Increase in Property Taxes.

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WORKSHEET FOR COMPUTING STATE TAX CREDIT
UNDER A FARMLAND DEVELOPMENT RIGHT AGREEMENT

Year	Net Farm Income	+ Capital Gains Income	+ Wage, Social Security Interest, Etc.	= Household Income	X 7%	= Base for Tax Credit	Property Taxes	- Base for Tax Credit	= State Tax Credit
					.07				
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