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Farmland and Open Space Preservation Act: Public Act 116

Michigan State University

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MICHIGAN STATE UNIVERSITY

**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 of 15 or more acres producing an annual gross income of \$2,000 or more from agricultural use and designated by the Michigan Department of Agriculture as a specialty farm.

The land does not have to be one contiguous area. Noncontiguous parcels which are a part of the farm operations may be included. A farm with nonagricultural operations can qualify, provided the application for the agreement includes a legal description of only the agricultural portion of the farm. 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.

The development rights agreement is a restrictive covenant upon the land. The landowner and the state, for a term of years, agree to jointly hold the right for land development. During the period of the agreement, the following restrictions are on the land:

1. No structures will be built or land improvements made except for a use consistent with farm operations,
2. A scenic, access or utility easement shall only be sold which does not substantially hinder farm operations,
3. Public access shall not be permitted on the land except with the permission of the owner, and
4. Any other restrictions, as agreed to by both parties, that are necessary to preserve the land as farmland.

Property tax relief is the incentive for the landowner to enter into a development rights agreement with the state. 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.

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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.

EXAMPLE OF TAX CREDIT CALCULATION

Situation

Net farm profit	\$10,000
Taxed share of capital gains	2,000
Excluded capital gains	2,000
Other income	1,000
Household income	<u>\$15,000</u>

Tax Credit Calculation

Property taxes	\$ 3,000
Base for tax credit (7% of household income).	<u>1,050</u>
Credit against state income tax	\$ 1,950
State income tax liability (4 exemptions).	414
Tax rebate	<u>\$ 1,536</u>

The example shows a property owner with a household income of \$15,000. Because property taxes on the land which was entered into the development rights agreement exceeded 7% of the household income, a tax credit of \$1,950 was possible. After subtracting the state income tax liability for the property owner, the state paid a tax rebate of \$1,536.

The property owner files for a tax credit each year under the agreement at state income tax filing dates. Each year the household income and property tax amounts are used to determine the credit for that year.

OTHER EFFECTS

Only structures which are consistent with farm operations or approved by the local governing body or state land use agency may be built. These 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.

The property owner does not have to pay 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 you sign up for the development rights agreement, you can still take advantage of the state homestead property tax relief.

MULTIPLE LANDOWNERS OR CORPORATIONS

If more than one person owns the farmland, property taxes are allocated to the respective individuals and the individual's share of property taxes are applied to his household income. The calculations are the same as those in the previous example for each individual. Multiple land owning situations are as follows:

- **Land owned in Tenants-In-Common or Joint Tenancy with Rights of Survivorship**—The property taxes are allocated to the owners in the same proportion as net income from the land.
- **Land owned by a partnership, estate, trust or subchapter "S" corporation**—property taxes are allocated to the owners in the same proportion as net income from the entity.
- **Land owned by a regular taxpaying corporation.**

A regular taxpaying farm corporation landowner is eligible for a farmland development rights agreement and a property tax credit against state tax liability. Because a farm corporation does not have household income as defined for an individual family unit, an alternative definition of corporation income is used. Adjusted business income is defined as the federal taxable income for the farm corporation plus compensation to stockholders. When calculating adjusted business income, federal taxable income must not be less than zero. Federal taxable income excludes any deductions for depletion allowance taken during the current taxable year. Since a farm corporation is exempt from the single business tax, a regular taxpaying farm corporation received a refund of property taxes greater than 7% of adjusted business income. The refund cannot exceed the total property tax due and payable by the claimant in that year.

A regular taxpaying corporation executing a farmland development rights agreement since January 1, 1978 has an additional eligibility requirement in order to claim a property tax credit or refund. A farm corporation must demonstrate that its agricultural gross receipts from farming exceed five times the property taxes on the land for each of three out of five tax years immediately preceding the year in which the credit is claimed. A property tax credit or refund for a regular taxpaying farm corporation is not allowed unless the gross receipts qualification is met.

The farm corporation may also meet the gross receipts qualification by comparing the average of the

most recent three years of agricultural gross receipts to property taxes in the first year that the corporation entered the program under the present contract. Once an election is made by the participant to compute the gross receipts qualification in the alternative manner, all future calculation must be made in the same manner.

THE DEVELOPMENT RIGHTS 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 tax bill with the tax description must accompany the application, along with a copy of the landowners deed and/or contract whichever is appropriate. Any liens, covenants, or encumbrances affecting the title should be noted in the application along with a brief explanation.

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 land owner. 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 disabled during the agreement, the land may be released from the agreement and be subject to a prorated repayment of the tax credits. 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—A landowner who decides he no longer wants the agreement may apply to have the agreement relinquished. However, early termination of the agreement is not automatic. The following factors are considered by the local governing body or the state land use agency in reviewing a termination application for a farmland development rights agreement.

1. That the agreement or easement imposes continuing economic inviability causing hardships through the prevention of necessary improvements to the land. Economic inviability consists of continued uneconomic operation because of the restrictions in the agreement or easement and not merely the existence of uses of the land that allow higher returns.

2. Surrounding conditions impose physical obstacles to the agricultural operation or prohibit essential agricultural practices.

3. Significant natural physical changes in the land which are generally irreversible and permanently effect the land.

The opportunity to sell land for development would not be considered adequate reason to terminate the agreement. Application for termination follows the same procedures as those used when 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.

HOMESTEAD PROPERTY TAX CREDIT

The state homestead property tax credit is separate legislation from the "Farmland and Open Space Preservation Act" and is available to all property owners for property tax relief. Any landowner considering a development rights agreement under P.A. 116 should coordinate this credit with the homestead property tax credit. Both tax credits can be taken on farmland, but the combined tax credits cannot be more than the property taxes. Because the homestead property tax credit need not be repaid to the state, and at least part of the P.A. 116 tax credit might be repaid, the homestead property tax should be taken before the P.A. 116 tax credit. However, the calculations for each tax credit are independent.

The following example shows the calculations:

Situation (Same as previous example)

Household income	\$15,000
Property taxes	3,000
State income tax liability	414
General tax payer (Not disabled or senior citizen)	

Homestead Property Tax Credit Calculation

• Amount not refundable	\$ 525
Household income	\$15,000
Rate035
Amount not refundable	\$ 525
• Excess over property taxes	\$ 2,475
Property taxes	\$3,000
Amount not refundable	525
Excess over property taxes	\$ 2,475
• Homestead property tax credit	\$ 1,200
Excess over property taxes	\$ 2,475
Rate6
Homestead property tax credit	\$ 1,485*

P.A. 116 Tax Credit

Same as previous example	\$ 1,950
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Summary of Tax Credits and Rebate

Property taxes	\$ 3,000
Homestead property tax credit	1,200
Balance to apply towards P.A. 116	\$ 1,800
P.A. 116 tax credit \$1,950, but limited to	\$ 1,800
Both tax credits	\$ 3,000
State income tax liability	414
Tax rebate	\$ 2,586

*Limited to \$1,200

This example shows that all the property taxes are returned to the property owner and a rebate is obtained from the state for property taxes less the state income tax liability. These calculations for your situation will show whether benefits are obtained from P.A. 116. You are probably already taking the homestead property tax credit.

EVALUATION OF MANAGEMENT FACTORS

You should evaluate many management factors in deciding whether to participate in P.A. 116. Participation under the Act is voluntary. Therefore, evaluate all the information at your disposal to help make your decision. Start with the following factors:

- Your feelings toward preserving land as farmland. Between 1945 and 1974, 41% of the land in Michigan farms changed to nonfarm uses.¹ P.A. 116 is one attempt to keep land in farming.
- Future use of your land. Is your land best suited for farmland? Is it located near nonfarm development?
- Years your family will operate the land as a farm. How many years will you farm? Will the next generation continue the business?
- How land development restrictions will limit your land use plans. The development rights agreement will not restrict your farming activities. But what about nonfarm developments? Do you plan to use your land for something other than farming?
- Benefits you obtain from the homestead property tax credit. Check your previous Michigan income tax forms to determine how much property tax credit was obtained. How much homestead property tax credit do you anticipate in the future?
- Expected future property taxes. Property taxes have been increasing in the past. At what rate have your property taxes been increasing? How much continued increase do you expect?

• Benefits you'll obtain from P.A. 116 property tax credit. Figure 1 on page 5 shows the breakeven ratio between household income and property taxes to obtain a P.A. 116 tax credit. If your household income is below the breakeven line between household income and property taxes, tax credits are possible for participation in P.A. 116. A worksheet is provided for you to calculate the yearly benefit under P.A. 116 for past years or projections for future years.

¹1974 Michigan Census of Agriculture.

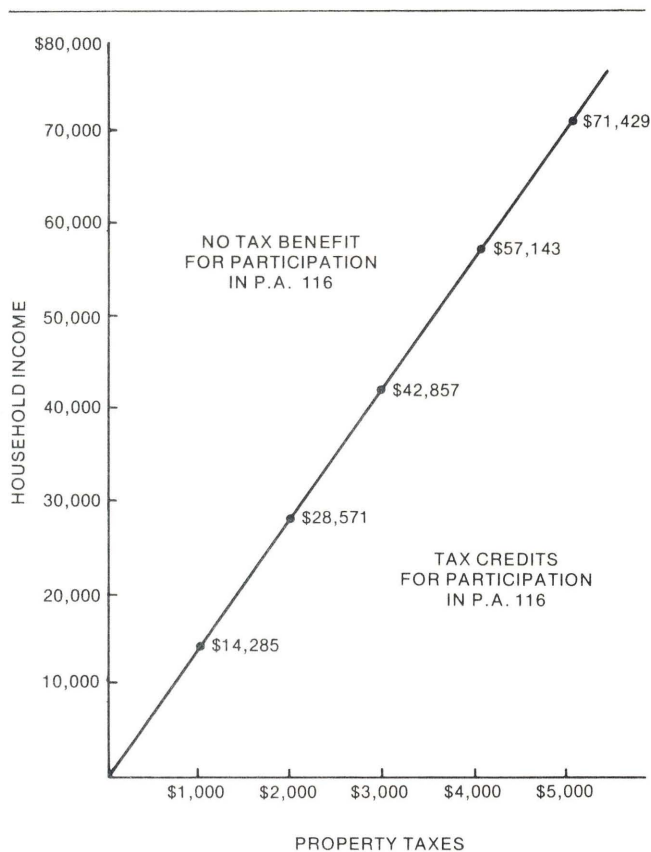


Figure 1.—Breakeven ratio between household income and property taxes to obtain a P.A. 116 tax credit.

SUMMARY

Michigan farmland is being rapidly converted to non-farm uses. This is a loss for Michigan agriculture and threatens your interest in keeping a farm business. The "Farmland and Open Space Preservation Act" is one way the state hopes to preserve farmland. Property tax relief is an incentive for your participation.

Property 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 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.

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).

Persons:—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
 P.O. Box 30028
 Lansing, MI 48909

