

**NORTH CAROLINA GENERAL ASSEMBLY**

**LEGISLATIVE FISCAL NOTE**

**BILL NUMBER:** SB 1161 (4th Edition)

**SHORT TITLE:** Amend Use Value Statutes and Other Tax Laws

**SPONSOR(S):**

<b>FISCAL IMPACT</b>					
	<b>Yes (X)</b>	<b>No ( )</b>	<b>No Estimate Available ( )</b>		
	<b><u>FY 2002-03</u></b>	<b><u>FY 2003-04</u></b>	<b><u>FY 2004-05</u></b>	<b><u>FY 2005-06</u></b>	<b><u>FY 2006-07</u></b>
<b>REVENUES</b>					
<b>General Fund</b>	Potential Revenue Change – See Assumptions and Methodology				
<b>Local Governments</b>	<b>* Potential Revenue Change *</b>				
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b> North Carolina Department of Revenue and Local Governments.					
<b>EFFECTIVE DATE:</b> Sections 1 – 7 are effective for tax years beginning on or after July 1, 2003. Section 10 becomes effective October 1, 2002 and applies to taxes levied on or after that date. Section 11 becomes effective October 1, 2002 and applies to payments due on or after that date. The remainder becomes effective when law.					

**BILL SUMMARY:** The bill has two primary components. The first component addresses the property tax treatment of special classes of property. Under current law, farmers are charged property taxes based on the land value for agricultural and horticultural purposes, rather than the full market price. In general, this value is lower than the market price because it does not reflect any potential alternative uses for the property (i.e. new homes, commercial development, or industrial facilities). Under the current system, the adjusted value for agriculture is based on the market price for corn and soybeans, as well as the cost of producing corn and soybeans. A Use Value Advisory Board is charged with determining the basis for horticultural land. The Use Value Advisory Board has generally created a manual each year. County tax assessors can use this manual to determine values under the use value program or can include their own values in line with the county’s schedule of values. This bill changes the current program in several ways. In Section 1, the proposal exempts certain agricultural, forestland, and horticultural land from the existing sound management program requirement, primarily if the “highest and best use” of the forestland is to serve as a buffer, or a small portion of the agricultural or horticultural unit is actually woodland. Second, it clarifies that the term “tenants in common” is a form of individually owned property for use value participation purposes. It also clarifies that each beneficiary of a family trust must be a natural person to meet the individually owned

requirements. This section also provides that the Use Value Advisory Board determines the appropriate income and capitalization rates to be used to determine use value.

Section 2 clarifies that when land under the use value program is transferred to a new owner who intends to continue under the program, the deferred taxes remain a lien on the property. It also requires that the new owner file an application for use value within 60 days of the transfer, certify that they intend to continue to use the property for an allowable activity under the use value program, and accept liability for the deferred taxes if the requirements are not met. This section also clarifies that land voluntarily removed from production due to participation in certain federal programs will not be considered in actual production for use value purposes. This section of the bill also addresses the issue of conservation easements, taxation of land subject to those easements, and the roll back of taxes when land is placed under a conservation easement. A conservation easement limits the ways a particular piece of land can be used, generally to limit development. As such, a conservation easement has the potential to lessen the “highest and best” use of the property, and therefore limit its value for property tax purposes. Under current law, when agricultural or forestland is placed under a conservation easement and continues to be actively managed, no change in tax value or roll back of taxes should occur. However, if land in the use value program is placed under an easement and is no longer actively managed, the county will collect a roll back of deferred taxes and will reassess the value of the property. This section of the bill removes the rollback when the land is placed under an easement and is removed from the use value program. It also insures that that particular parcel will continue to be taxed as agricultural or forestland as long as the easement is in place, regardless of the actual use of the land.

Section 3 modifies existing law to allow a taxpayer to file an application at any time during the calendar year if such an application is required due to a land transfer. It also clarifies that failure to have an application approved is grounds for disqualification from the program.

Section 4 makes the most significant changes to current law in this component of the bill. It modifies both the membership and duties of the Use Value Advisory Board. The new members include a representative of the Farm Bureau, a representative of the NC Association of Assessing Officers, the Director of the Property Tax Division of the Department of Revenue, a representative of the NC Association of County Commissioners, and representative of the Forestry Association. The Board is now charged with determining expected net incomes per acre for agricultural and horticultural land based on cash rental rates. (Currently yields and prices of corn, soybeans, and various horticultural products are used as the base.) Thus, this section of the bill changes the tax basis for both types of land to cash rents. Section 4 also requires that the Use Value Advisory Board annually select a capitalization rate for converting incomes into values. This capitalization rate must be between 6% and 7%. It also limits the maximum value for agricultural land to \$1,200 per acre.

Section 5 requires the Department of Revenue to study cash rents for agricultural lands, and moves some existing language to a different section of the Machinery Act. Section 6 authorizes the assessor to request assistance in the review and clarifies that the assessor may require the owner to submit evidence of the existence of a sound management plan. Section 7 gives county commissions the authority to assign county agents or contract with other state and federal agencies to assist with the use valuation process.

Section 8 of the bill creates a property tax subcommittee of the Revenue Laws Study Committee. This subcommittee will include six (6) members, and is charged with studying, examining, and, if necessary, recommending changes to the property tax system. The subcommittee is also instructed to examine all classes of property, including exemption and exclusions. This subcommittee is also charged with studying the present-use value system. All reports and recommendations are to be made to Revenue Laws.

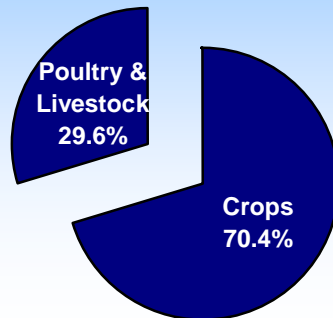
The second component of the bill addresses several technical issues considered by Revenue Laws. Specifically, Section 9 clarifies that equipment used to dispense plant growth inhibitors is not exempt from sales tax. Section 10 changes the due date for quarterly sales tax returns from the 15th of the month to the last day of the month, following the end of the quarter. Section 11 changes the underpayment penalty calculation for semimonthly taxpayers to conform to the Streamlined Sales Tax Project. Section 12 clarifies the use of sales and use tax exemption certificates.

### **BACKGROUND:**

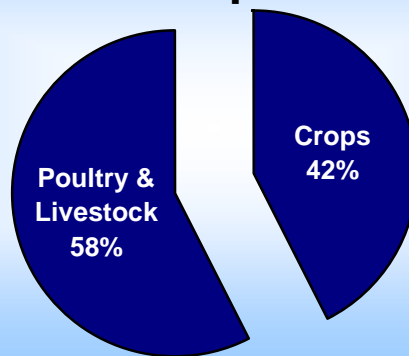
Under G.S. 105-289(a)5 the Department of Revenue and the Use Value Advisory Committee are instructed to develop a manual to assist county assessors in determining the use-value of agricultural, horticultural, and forestland. The law states that the use value should be based on expected net income from the property. The expected net income for agricultural land is based on actual yields, the price of corn and soybeans for the past five years, and the actual cost of growing corn and soybeans during that same period. The law allows the committee to set a method for determining the income potential of horticultural land. At the time this law was adopted, crops represented 52.8% of agricultural cash receipts.

In 1996, 1997, and 1999 the Revenue Laws Study Committee was informed that corn and soybean prices might no longer be the most appropriate method for determining the expected income for farmland, as crops were no longer the primary agricultural product of the state, and corn and soybeans represent an extremely small subset of crop receipts. As noted in the charts below, the proportion of agricultural cash receipts that come from crops has declined from 70.4% in 1964 to 42.4% in 2000. In 2000, corn and soybeans are only 3.8% of the total farm cash receipts, suggesting that those two items were approximately 8.9% of the crop total.

## 1964 Proportion of Agricultural Cash Receipts



## 2000 Proportion of Agricultural Receipts



**SOURCES OF DATA:** North Carolina Department of Agriculture and Consumer Services, Agriculture Statistics Section.

In 1996, Revenue Laws was also informed that cost of production data for corn and soybeans was also no longer available, as the federal government no longer created that database. As a result of these two factors, limited data and shifts in agricultural production, Revenue Laws directed the Use Value Advisory Board to study the issue and return to Revenue Laws with their recommendation for a new system.

### **ASSUMPTIONS AND METHODOLOGY:**

There are three primary fiscal impact related issues in the bill.

#### Agricultural Use Value

In May 1998 researchers from the North Carolina Cooperative Extension Service conducted a statewide survey to determine the appropriateness of cash rent as a new basis for the use value system. The survey asked Extension Directors, Tax Assessors, Farm Credit Service Appraisers,

and farmers to provide estimates of agricultural land values (when sold as agricultural land) and agricultural cash rents. Estimates were given for low, medium, and high productivity land. The data was sorted by region (referred to as a Major Land Resource Area or MLRA). Allowances were also made for quota crops. The Extension Service received responses from 98 County Extension Directors and 98 County Tax Assessors. Farm Credit also gave estimates for all 100 counties. They received at least one farmer response from 75 counties.

When the Use Value Advisory Board compared the sale price of farmland sold as farmland to the cash rent derived from that land, it found the average rent to value ratio to be 2% in most of the MLRAs. The notable exception is the Tidewater region where the average rent to value ratio is 4.5%. This ratio most closely reflects the true rent to value ratio because the agricultural use of the property in that region is often its highest and best use since there are not many competing pressures to increase the value of the property. For this reason, the Use Value Advisory Board recommended using a 5% capitalization rate. Also, 5% is the nationwide average capitalization rate for farmland.

Since that time the Department of Revenue and the Extension Service have attempted to update their findings. This new survey indicates that only 57 counties are currently using the Use Value Advisory Board manual, while 39 are not (4 counties did not report or did not have agriculture acres in the use value program). The data also showed that at a 6% cap rate under a cash rent system, 64 counties would gain revenue, while 32 would lose. At 7% the numbers move to 40 counties that will gain and 55 that will lose revenue. (The Use Value Advisory Board is charged with choosing a rate between 6% and 7%). The average rent to value ratio in this survey was 7.57%. A review of the newer revaluations suggests an average rent to value ratio of 6% or less.

At this time no data is available on the number of acres in the program in each county. Therefore, no overall estimate of the fiscal impact of this portion of the bill is possible. Additionally, no good data is available on the impact of the other changes in the bill, although the overall statewide impact is expected to be fairly small.

### Conservation Easements

Section 2 of the bill makes two changes to the property tax treatment of lands subject to a conservation easement. The first of these relate to tax rollbacks. Under current law, if land no longer used for the purpose for which it receives special tax treatment under the use value program, the owner of that property is subject to what is called “roll back”. This essentially means the owner has to pay the difference between the tax on the property if it would have been valued at “market” and the tax on the property under the use value program, for the past three years. Under this legislation, the property owner would no longer be subject to the roll back if the land was subject to a conservation easement. A statewide survey of tax assessors indicates the following amounts were remitted to responding counties for “roll back” in the most recent fiscal year:

<b>County Name</b>	<b>Rollback</b>	<b>Include Municipal Taxes?</b>
Alexander	\$11,600.00	No
Buncombe	\$158,564.10	Yes
Catawba	\$28,460.44	Yes
Chatham	\$87,717.00	No
Chowan	\$16,743.06	Yes
Cleveland	\$116,729.00	Yes
Cumberland	\$162,505.44	Yes
Currituck	\$38,940.00	No
Davie	\$40,991.90	Yes
Durham	\$213,849.67	Yes
Forsyth	\$105,950.16	Yes
Gaston	\$28,098.00	Yes
Greene	\$34,410.00	?
Haywood	\$44,817.00	?
Henderson	\$19,011.61	No
Hertford	\$27,838.00	Yes
Hoke	\$52,457.14	No
Jackson	\$7,165.20	No
Johnston	\$163,190.55	Yes
Jones	\$17,360.95	No
Lee	\$7,384.06	Yes
Macon	\$35,470.00	No
Mecklenburg	\$697,441.23	Yes
Moore	\$58,000.00	Yes
Nash	\$122,362.00	No
New Hanover	\$67,666.00	Yes
Northampton	\$22,472.00	Yes
Onslow	\$30,846.00	Yes
Pasquotank	\$24,791.10	No
Pender	\$70,797.00	No
Person	\$28,202.00	Yes
Pitt	\$229,445.00	?
Randolph	\$46,782.03	No
Rockingham	\$83,230.00	?
Rutherford	\$18,495.84	Yes
Scotland	\$10,932.40	No
Stanly	\$22,000.00	Yes
Surry	\$33,633.00	No
Union	\$95,739.47	No
Washington	\$21,113.00	No
Wayne	\$53,300.00	Yes
Wilkes	\$17,470.63	No
Yadkin	\$20,720.53	No
<b>TOTAL</b>	<b>\$3,194,692.51</b>	

This amount represents the total amount of roll back under all circumstances, not the amount of roll back due to leaving the agriculture use program under a conservation easement. According to property tax experts, the proportion of this amount is likely to be relatively small, but no specific numbers are available. At present, Fiscal Research is aware of two properties – one in Wake and one in Rutherford – where land that is currently under the use value program may become subject to a conservation easement. Other situations could exist, but are not known to Fiscal staff. Further, it is expected that the amount and value of land placed under a conservation easement will vary according to federal tax incentives. As such, no fiscal estimate is possible on this portion of the bill.

The second fiscal impact relating to conservation easement relates to the tax treatment of that land over time. As was mentioned previously, this bill continues to hold land that was under the use value program in the program as long as the property is under a conservation easement. This means that property that was once in active agricultural production would continue to be treated as if it was in production, regardless of how the land is now used, as long as it is subject to a conservation easement. Fiscal Research is not aware of any other state that treats land under conservation easement in exactly the same manner. Officials at the Clean Water Management Trust Fund have also attempted to develop an estimate based on their plans and that of similar organizations. However, because of the complexities of the bill and the limited data on property tax values related to easement, no data is available at this time. As such, no fiscal estimate is possible on this portion of the bill.

#### Other Revenue Issues

The third portion of the bill relates to other revenue related changes recommended by the Revenue Laws Study Committee.

Section 9: This proposal is a result of a North Carolina Court of Appeals decision. In American Ripener Co. Inc. v. Muriel K. Offerman, Secretary of Revenue, the court considered the application of state sales taxes to a plant growth regulator or stimulator which controls the ripening of fruits and vegetables (ethylene), as well as the equipment used to deliver that chemical. Tax on replacement parts was also an issue. The court held that all of these items are exempt from sales and use tax under G.S. 105-164.13(2) and G.S. 105-164.13 (2a) which exempts “plant growth inhibitors, regulators, or stimulators for agriculture including systematic and contact or other sucker control agents for tobacco and other crops”. The court also ruled that the generators and associate parts are also inhibitors and are therefore exempt from sales tax. The proposal effectively amends G.S. 105-164.13(2a) to make the equipment and parts associated with this gas treatment subject to sales and use taxes. (The Department had previously assumed all these items were taxable). In making it’s ruling, the court effectively reduced sales tax revenue. The bill would restore at least some of that revenue to the General Fund. As such, the bill in and of itself would create a small revenue gain. However, Fiscal Research is unable to create an exact estimate of the value of ethylene delivery parts and equipment. As a result, no estimate is possible on this portion of the proposal.

Section 10: Currently the Department of Revenue receives monthly withholding returns, monthly sales tax returns, and quarterly sales tax returns on the 15th of the month. On the 15th of March, April, September, and October income tax returns are due as well. Shifting the due date of quarterly sales and use tax returns from the 15th of the month to the end of the month will create a more even distribution of work in the Department. Because the payments are due in the month

following the end of the quarter (October, February, April, and July) the shift will not move any revenue from one fiscal year to the next. Some loss of interest on the payments or “float” will occur. However, because of the relatively small sums of money involved, the Department expects the loss to be minimal.

Section 11: This section changes the calculation of penalty for underpayment by semimonthly sales tax payers. Under current law, the taxpayer must remit at least 95% of the amount due for each semimonthly payment period. This proposal allows the taxpayer to remit the lesser of this amount or the average semimonthly payment for the prior calendar year. Clearly this proposal will result in some loss of penalty revenue. However, no data is available to determine the magnitude of the loss. The Department expects the loss to be slight.

Section 12: Historically the Department of Revenue has issued exemption certificates to taxpayers in certain exempted industries to facilitate tax administration. However, there is no reference to exemption certificates in the statutes, except as it relates to penalties for misuse of such a certificate. This proposal would codify the practice of issuing exemption certificates. Since the proposal is only codifying the existing practice of the Department, no fiscal impact is expected.

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**DATE:** August 21, 2002



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