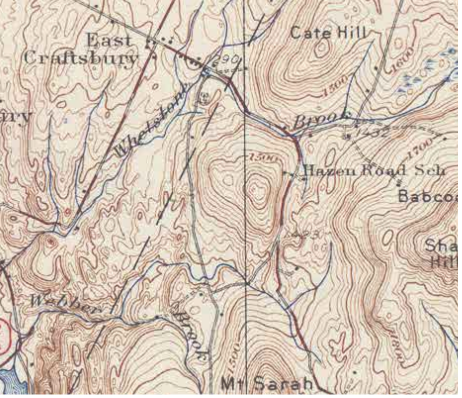


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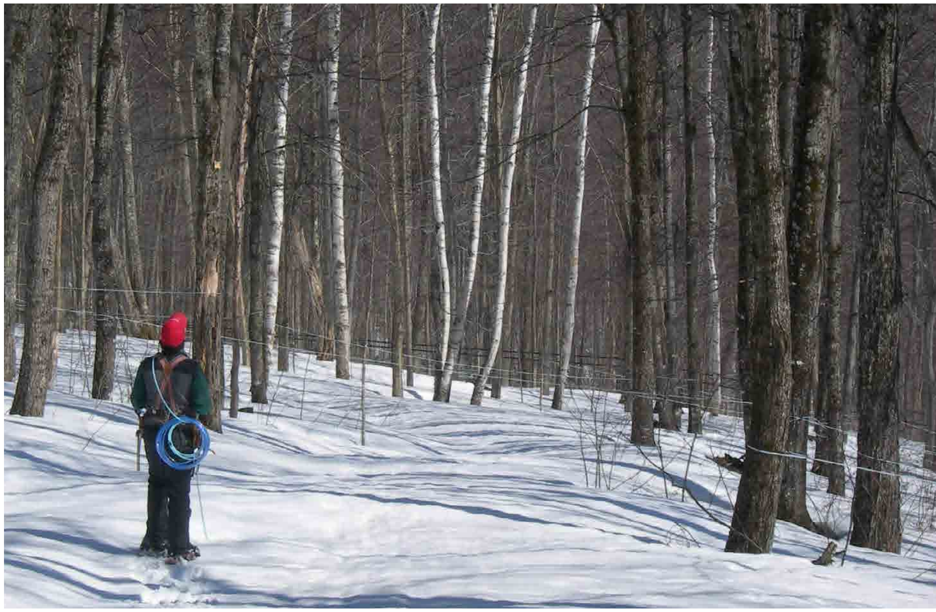
farm to plate

STRENGTHENING VERMONT'S FOOD SYSTEM

# SUSTAINING AGRICULTURE

## Farmland and Property Taxes







AGRICULTURE LAND USE PLANNING TASK FORCE

# SUSTAINING AGRICULTURE

The Agriculture Land Use Planning Task Force of the Farm to Plate Network has developed a series of planning guidance modules that build off the work of ***Sustaining Agriculture***, an agriculture planning guide from the 1990s developed by the Agency of Agriculture.

1. Agriculture and Food Systems Planning
2. Agricultural Land Conservation
3. **Farmland and Property Taxes**
4. Local Regulatory Context
5. State Regulations

farm to plate

STRENGTHENING VERMONT'S FOOD SYSTEM

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On the cover: Sunflowers and State Line Farm combine: VSJF; Ira Marvin inspects taps on Butternut Mountain Farm: Butternut Mountain Farm; Highland Beef grazing: Greenfield Highland Beef; sunset dinner: Sandiwood Farm; raised beds: Radical Roots Farm; Pete's Greens Waterbury Farm Market, Newport Tasting Center: Rachel Carter; High Mowing Organic Seeds spinner rack: High Mowing Organic Seeds.


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# FARMLAND AND PROPERTY TAXES

## I. Overview

To both the farmland owner and other taxpayers in the town, the property tax is extremely important. The farmland owner can be faced with a property tax bill that exceeds the annual income from agriculture. Unless this bill is reduced, farming the land would not be a rational decision. On the other hand, the operation of the town and school district depend on the property tax for revenue. Taxpayers worry that any reduction in the amount paid on farmland property taxes would increase tax bills for others, many of whom are also feeling they cannot afford to pay any more.

To sustain agriculture as well as the town and school, the property tax problem must be solved for both the farmland owner and local government. The landowner's taxes must be reasonable, and the town must be able to afford any tax shift that might occur.

Often, the perception of property tax consequences does not match reality—especially since Vermont has changed the way schools are financed. Although towns send out one property tax bill for each parcel, the bill includes two separate property taxes: the municipal tax and the school tax.

The municipal property tax rate is determined by dividing the town budget (not including the school budget) by the tax base. Therefore, if the tax base is reduced while the budget remains constant, the tax rate will go up.

This is not the case for the school part of local taxes. Neither the nonresidential nor the homestead school rate is based on the tax base in the town. When the local tax base is reduced, it is the state education fund—not the municipality—that loses school tax revenue. As a result, the state rates would go up for all property taxpayers in the state, so the cost is absorbed by the state as a whole rather than by the host town alone.

**In light of these important differences between the municipal property tax and the school property tax, the purpose of this section is to explain how farmland is taxed currently and what would happen in both the short term and the long term if some of the farmland protection tools available to communities were utilized**. In this way, taxpayers and farmland owners can better understand the tax implications of conservation decisions.

### How the School Tax Works

All nonresidential property in every school district pays a school tax calculated in FY 2014 as $1.43 per $100 of property value. For homestead property, the school tax rate is based on the spending per pupil approved by local voters. Annually, the state sets a base tax rate and a base spending amount. Each school district's homestead rate is a factor of the base rate. A district with per-pupil spending that is 125 percent of the state-set base spending amount would have a homestead tax rate that is 125 percent of the state-set base rate (32 V.S.A. § 5402).

## II. Vermont's Use Value Appraisal Program

Vermont statutes call for all property, except for property enrolled in the Use Value Appraisal Program, or current use, to be appraised at its fair market value for property tax purposes. Fair market value is defined as *"the price which the property will bring in the market when offered for sale and purchased by another, taking into consideration all the elements of the availability of the property, its use both potential and prospective, any functional deficiencies, and all other elements such as age and condition which combine to give property a market value"* (32 V.S.A. § 3481).

Because the price that farmland will bring in the market often exceeds the annual income from the land, the Use Value Appraisal Program substitutes a value based on the income-producing potential from agriculture for the fair market value, and a farmer's barns are valued at $0 (32 V.S.A. Chapter 124). To enroll land in the Use Value Appraisal Program, landowners agree to have a lien placed on the property to secure a penalty—known as the Land Use Change Tax—if the land is developed.

The use value is currently determined at the state level based on the average rental value of agricultural land. This value is substantially lower than the fair market value, and as a result, the use value tax bill is roughly 10 percent of what the tax bill would otherwise be, although it varies depending on the market value of the land.

The program has been crucial to sustaining agriculture. At this point, it is estimated that more than three-quarters of Vermont farms are enrolled in the Use Value Appraisal Program. However, there are still some landowners who have not enrolled their land because they don't understand all the pros and cons of the program; providing information and answering questions could make a big difference in helping these people continue farming.

Although a tax shift occurs due to the Use Value Appraisal Program, it is borne by taxpayers across the state and not by the property taxpayers in the host towns alone. When the tax base is reduced by Use Value Appraisal, the state education fund receives less revenue and the state-set rates rises for all property in the state. **To prevent towns from losing municipal property taxes, the state calculates what the town "lost" by taxing land based on its use value and sends a payment to make up the difference**.

### Local Tax Stabilization

Towns may set up their own tax stabilization agreements to sustain agriculture (32 V.S.A. § 3846 and 24 V.S.A. § 2741). Before the state Use Value Appraisal Program began, more than thirty towns offered tax relief to farms through local programs. Once the state program was underway, most towns abandoned their local programs for two reasons: (1) the state program is often a better financial deal for the landowners, and (2) the state makes up taxes that are lost so local taxpayers do not have to absorb the entire cost.

The legislation authorizing local tax stabilization remains on the books. A town is free to craft a local farmland stabilization contract to target specific needs or to supplement the state program.

The town is allowed to stabilize the taxes on farmland by setting and freezing any of the following for the contract period (up to ten years):

- The taxable value
- The tax rate
- The amount of tax due annually
- A percentage of what the tax bill would be without stabilization

No matter which local tax stabilization method is used to reduce the farm tax bills, the result would be a reduction in the amount the town would receive from the municipal tax and a reduction in the amount the state education fund would receive from the school tax. The town would need to make up for the entire reduction—including the school taxes that go to the state education fund. The reduction in municipal tax is made up by raising the municipal rate. The reduction in school tax is made up by creating what is called a "local agreement rate" to raise the amount needed to cover the school taxes otherwise lost to the state education fund as a result of the stabilization agreement (32 V.S.A. § 5404a).

### Examples of Local Tax Stabilization in Vermont

***Stowe*** continues to support a local program that began before the state program, partly because there are important farms whose owners are more comfortable dealing with locals than with the perceived vagaries of Montpelier, land values and development pressure on those lands are high, and the town voters feel financially capable to offer the program.

***Brattleboro's*** enrolled farmers first benefit from the current use program—that is, their productive land's assessments on both the town and state grand lists are reduced by the current use program—and then are reduced to zero for municipal taxation. The local tax stabilization program may reduce the farmer's residence and home-site assessment to zero, once the farmer files information showing that two-thirds of their income (of all residents of the property) is produced from agricultural activities. There are only five farmers left in the program—a total of about 1,300 acres—so the town is not foregoing a large amount of municipal tax collections.

***East Montpelier*** on the other hand, recently voted to discontinue its program, and ***Jericho*** is phasing its program out by 2016, as it has dwindled to three properties now being subdivided (no penalty was included). ***Underhill*** continues to support, along with Stowe and Brattleboro, a local program. (Source: 2013 correspondence with town staff)

## III. Conservation Easements and Property Taxes

Property is often described as a bundle of rights, and the fair market value of the land depends on which of those rights may be exercised by the landowner. The right to develop the property according to applicable laws and regulations is particularly important in determining the fair market value of the property. When a governmental agency or a conservation organization acquires a conservation easement on agricultural land, the right to develop is extinguished on much of the land. Often, this reduces the appraised value of the property.

The taxable value of land subject to a conservation easement should be based only on the remaining rights if the easement is held by any of the following (10 V.S.A.§ 6301a and § 6306):

- State agencies including the Agency of Natural Resources; the Agency of Transportation; the Agency of Agriculture, Food, and Markets; and the Vermont Housing and Conservation Board
- The municipality
- Qualified conservation organizations, with certification from the Vermont Department of Taxes

There is no rule of thumb to estimate how a conservation easement would affect the value of a property. Some easements allow limited development, while others don't. In some cases, according to appraisers, there is no change in value because the highest and best use remains the same. Many agricultural easements include an Option to Purchase at Agricultural Value, which generally lowers the resale value considerably.

Assuming the easement results in a drop in the appraised value of a parcel, the town would lose municipal taxes (causing an increase in the municipal tax rate) and the state would lose school taxes (causing an increase in school rates applied statewide).

From the farmland owner's point of view, the appraised value of the land after the easement is completed is rarely as low as the use value. Participation in the Use Value Appraisal Program or some other tax stabilization program will still be important to reduce property taxes to a level that is financially viable given farm income.

## Transfer of Development Rights and Property Taxes

Once development rights have been transferred, the sending parcel is appraised as a parcel with a conservation easement and the receiving parcel is appraised as a parcel with the potential to host a higher density development. Generally, this would decrease the value of the sending parcel and increase the value of the receiving parcel.

In practice, however, there may not be a strong market for the development rights, so there may not be a basis for increasing the value on the receiving parcel. In addition, depending on the original zoning and valuation of the sending parcel, the conservation easement may have little effect on the value of the sending parcel.

If the conservation easement is perpetual, the sending and receiving parcels would be valued according to their remaining rights for both municipal and school tax purposes.

If the conservation easement is not permanent, the sending parcel would be valued accordingly for municipal tax purposes. However, if the nonpermanent easement has reduced the value of the parcel according to the town listers, the town must make up the tax difference to the education fund. This is done by assessing a "local agreement" tax on the municipal grand list (32 V.S.A. § 5404a).

There is a potential timing issue. If the conservation easement is placed on the sending parcels prior to attaching the transferred development rights to a receiving parcel, the value of the sending parcel may decrease without any compensating increase in taxable value on a receiving parcel. The development rights themselves are not taxable.

From the farmland owner's point of view, the appraised value of the sending parcel after the easement is rarely as low as the use value. Participation in the Use Value Appraisal Program or some other tax stabilization program will still be important to reduce property taxes to a level that is financially viable given farm income.

## Property Tax Implications of Fee Simple Acquisition by the Town, State, or a Qualified Conservation Organization

In some cases, the town, state, or a conservation organization may purchase agricultural land with all its rights. Most often, the purpose would be to place an easement on at least most of the parcel and sell or lease it to a farmer.

If an agency or a conservation organization owns the land, it is taxable. If it is subject to a conservation easement, its value for tax purposes would be based on the remaining rights.

If the town is holding the land for conservation or other municipal purposes, it is not taxable. However, if the town plans to own the land and lease it to a private entity, it is probably taxable. The best way to handle the situation would be to have the lease cover tax payments.

## IV. Long-Term Tax Implications of Farmland Protection

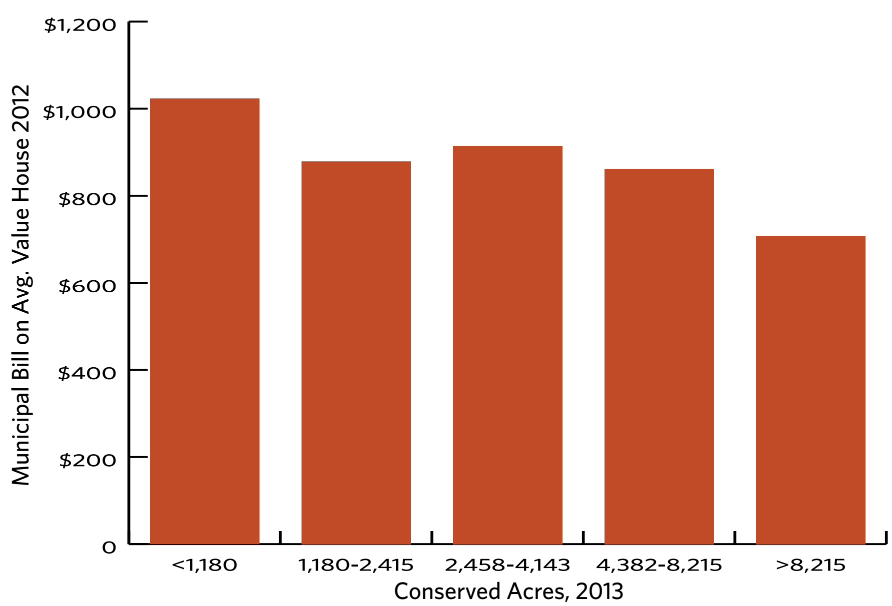
When property taxes are reduced on one parcel of land, in order for the town to meet the financial obligations of the voted annual budget, the taxes must be made up by increasing the tax rate on all property in the town. This immediate tax shift can be calculated. Taxpayers, however, are concerned not only about the short-term tax shift, but also about the long-term tax implications. By permanently precluding the possibility of using the land for new houses or commercial enterprises, is the town locking itself into higher tax rates?

This is a difficult question to answer as every town is different. However, it is instructive to look at what has actually been happening in Vermont. Because school property tax rates in Vermont are no longer a function of the town's grand list, the charts below show the municipal (not including school) tax bill on the average-value house in town.

The first question is whether towns with more conserved land have higher tax bills. In the chart below, all Vermont towns were ranked by the number of acres of conserved land and divided into five groups—each with 20 percent of the towns. The municipal tax bill on the average-value house was calculated for each town and averaged for each of the five groups. The height of the bar represents this average municipal tax bill.

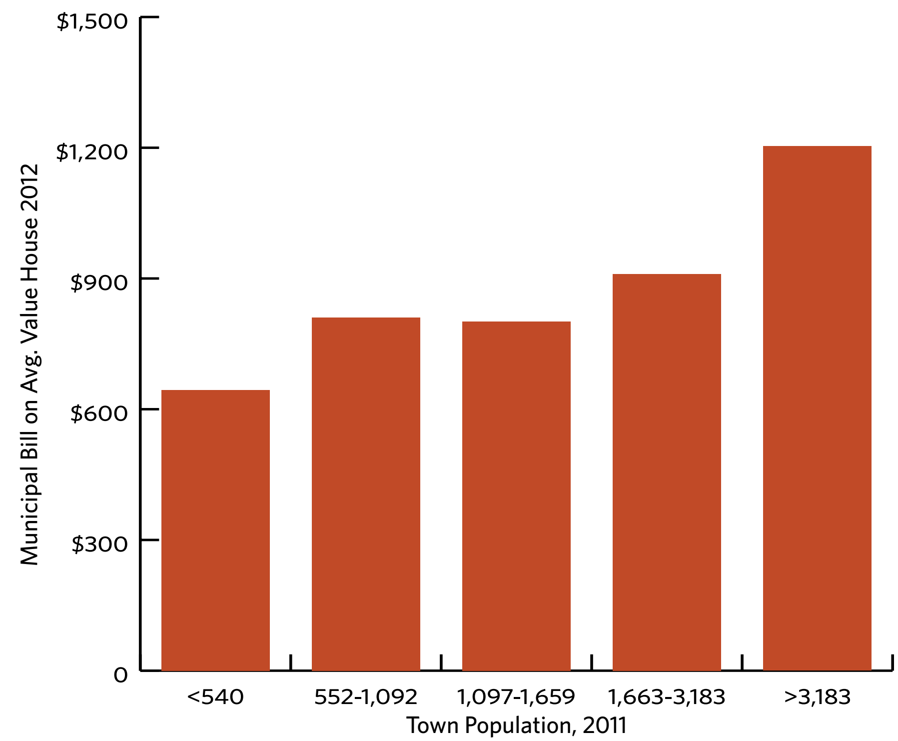
In general, the towns with the most conserved land have lower, rather than higher, municipal tax bills. This is not because of conserving land,

**Figure 1: Conserved Acres and Municipal Tax Bill on Typical House**




**Source:** *Property Valuation and Review*

**Figure 2: Population and Municipal Tax Bill on Typical House**

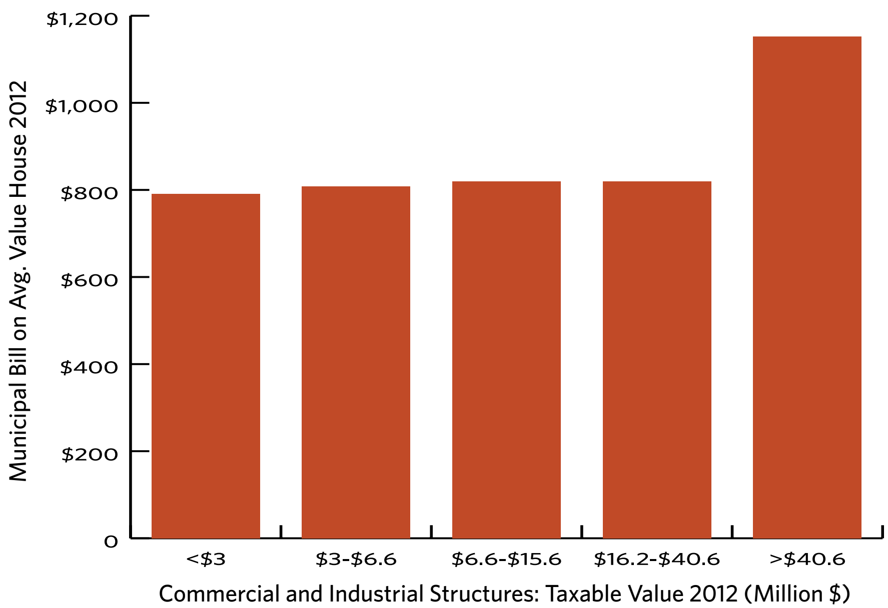



**Source:** *Property Valuation and Review* but rather because the towns tend to be more rural and therefore need fewer municipal services.

The flip side of the question is to look at towns that have attracted more growth and development to see if the tax bills are lower. The most obvious measure of growth in towns is population. In the chart below, all Vermont towns were ranked by population and divided into five groups—each with 20 percent of the towns. Although larger populations may mean larger tax bases, they also usually mean more town services are required, resulting in larger town budgets. In general, taxes are higher in towns with more residents.

Commercial or industrial development is often looked at as a net fiscal gain to the town. While this may be true in terms of jobs and economic vitality, it is not the magic cure for high taxes. In general, the Vermont

**Figure 3: Commercial Property and Municipal Tax Bill on Typical House**




**Source:** Property Valuation and Review

towns with the most commercial and industrial development have higher municipal tax bills. This is not due to the commercial enterprises themselves, but rather to the combination of economic activity and population growth that demand more municipal services.

In the chart below, all Vermont towns were ranked by the taxable value of commercial and industrial developments and divided into five groups—each with 20 percent of the towns. The municipal tax bill on the average-value house was calculated for each town and averaged for each of the five groups. The height of the bar represents the average municipal tax bill for each group.

**The conclusion to be drawn from these charts is not that growth raises tax bills, but rather that we should not be looking for growth as a way to lower taxes. Similarly, we should not be looking at farmland conservation as something that prevents us from attracting development that could lower tax bills and provide quality jobs or homes.**

## V. Resources

Vermont Department of Taxes Division of Property Valuation and Review, *Property Valuation and Review Report: 2012 Annual Report*, www.state.vt.us/tax/pdf.word.excel/pvr/reports/2012/2012AnnualReport.pdf.

U.S. Census Bureau, "Table 1. Cumulative Estimates of Resident Population Change for the United States, States, and Puerto Rico: April 1, 210 to July 1, 2011," www.census.gov/popest/data/maps/2011/MAP-EST2011-01.xls.

Commercial and industrial improvements, inventory, equipment from 2012 Grand List equalized using the 2012 common level of appraisal from *Division of Property Valuation and Review Acres conserved 2013* from Jon Osborne, Vermont Land Trust.