

DIFFERENTIAL ASSESSMENT AND THE PRESERVATION OF OPEN SPACE*

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The loss of prime agricultural, forest and open space lands is one of the central problems currently facing the United States. While estimates vary considerably,¹ it is certain that hundreds of thousands, and possibly millions, of acres of open land are being converted to other uses every year. Both Congress² and the states³ are grappling with a

* This Article is an adaptation and up-dating of REGIONAL SCIENCE RESEARCH INSTITUTE, *UNTAXING OPEN SPACE: AN EVALUATION OF THE EFFECTIVENESS OF DIFFERENTIAL ASSESSMENT OF FARMS AND OPEN SPACE* (1976), a detailed evaluation of the effectiveness of differential assessment laws for conferring tax benefits and preserving open space. *UNTAXING OPEN SPACE* also contains case studies of the operation of these laws in California, Connecticut, Hawaii, Indiana, Maryland, New Jersey, New York, Oregon, and Washington and an extensive bibliography. I wish to acknowledge the thoughtful contributions of David Berry, Robert E. Coughlin, James Farnam, Eric Kelly, Thomas Plaut and Ann Louise Strong who shared in the research for and writing of that study.

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1. See U.S. DEP'T OF AGRICULTURE, *Trends in Land Use and Competition for Land to Produce Food and Fiber*, in *PERSPECTIVES ON PRIME LANDS* 1-36 (1975).

2. In the Tax Reform Act of 1976, Congress amended the estate tax provisions so that under carefully defined conditions, farm real estate inherited by a member of a decedent's family may be valued at farm use value instead of fair market value, and provided for a recapture of some or all of the foregone tax revenue if the property is sold to non-family members or converted to another use within 15 years of death. Tax Reform Act of 1976 § 2003, I.R.C. § 2032A. The tax-writing committees intended to reduce the pressures for sale or conversion resulting from heavy estate tax obligations. H.R. REP. No. 1380, 94th Cong., 2d Sess. 5, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 3356, 3359. See BUREAU OF NATIONAL AFFAIRS, *TAX MANAGEMENT PORTFOLIO 299, VALUATION OF REAL ESTATE A-13 to A-20* (1977).

3. The New Jersey legislature has authorized an experimental \$5 million Agricultural Preserve Demonstration program for the acquisition of development rights to farmland in Burlington County, which is now in its early stages of implementation. N.J. STAT. ANN. § 4:1B (West Supp. 1977). Several municipalities are experimenting with transferable development rights, although few rights have actually been transferred. In essence,

wide variety of proposals which seek in one way or another to retain open land. Most states have promulgated or are in the process of promulgating land use policies which necessarily address the problem of retention of agricultural land.⁴ We are in a time of innovation and experimentation in which federal, state and local governments are testing new ideas and reworking old ones in a complex and probing attempt to find ways of preserving agricultural and other open lands within the constitutional, economic and political parameters of the rural land market.

While governments at all levels have been considering novel approaches to preserving open space, state legislatures have participated in a little noticed but remarkable movement that has led to the widespread enactment of so-called differential assessment laws. These statutes authorize the assessment of eligible land at its current use value instead of its fair market value, thus reducing the real property taxes that are levied on the land. They have been enacted under the banners of preserving open space and easing the tax burdens on farmers, and rest on the fundamental principle that, by reducing property

the concept involves the severance of development rights from a piece of privately-owned property combined with a guarantee to the owner that the rights can vest in the future on a similarly situated piece of property. For a further explanation of the concept, see J. COSTONIS, *SPACE ADRIFT* (1974); Foster, Schnidman & Bailey, *Transferable Development Rights: Are They a Step in the Direction of Better Land Use Management*: 34 *URBAN LAND* 28 (1975); Schnidman, *Transferable Development Rights: An Idea in Search of Implementation*, 11 *LAND AND WATER L. REV.* 339 (1976). See also Keene, *Transferable Development Rights*, in *TOUGH CHOICES IN TODAY'S WORLD* 250-59 (1977); Woodbury, *Transfer of Development Rights: A New Tool for Planners*, 41 *J. AM. INST. PLANNERS* 3 (1975).

Many counties in California have enacted sophisticated agricultural zoning programs. See, e.g., King County's Agricultural Protection Program, King County, Cal., Ordinance 3064 (Feb. 4, 1977). New York passed an Agricultural District Law in 1971, permitting county governments to authorize differential assessment of agricultural tracts of 500 acres or more. N.Y. AGRIC. & MKTS. LAW §§ 300-307 (McKinney 1972 & Supp. 1976). The law also prevents local governments from restricting farming practices beyond the requirements of health and safety, requires public agencies seeking to condemn land in the districts to show that acceptable substitute sites are not available, and limits the power of public utility districts to assess charges against farmland for services not needed by farmers. *Id.* Over a million acres, or about 10% of the state's agricultural land has been put in such districts. See METROPOLITAN WASHINGTON COUNCIL OF GOVERNMENTS, *FARMLAND RETENTION IN THE WASHINGTON METROPOLITAN AREA* 39 (1976).

4. See Collins, *Agricultural Land Preservation in a Land Use Perspective*, 31 *J. SOIL AND WATER CONSERVATION* 182 (1976). For instance, it has been proposed that Pennsylvania create agricultural districts similar to those in New York, change the state inheritance tax law so that farms are valued at agricultural use value, and adopt new incentive programs to encourage farmers to continue farming land. GOVERNOR'S OFFICE OF STATE PLANNING AND DEVELOPMENT, *A LAND POLICY PROGRAM FOR PENNSYLVANIA: AN INTERIM POLICY REPORT* (1976). For a list of states that have promulgated similar land use policies, see *LAND USE CONTROLS IN THE UNITED STATES* 253-56 (E. Moss ed. 1977).

taxes, the rate at which farmland is being converted to non-farm uses can be significantly decreased.

Since 1956, when Maryland enacted the first differential assessment statute, forty-four state legislatures have passed laws which grant preferential treatment to farm or other types of undeveloped land.⁵ Of

5. Alaska: ALASKA STAT. § 29.53.035 (Michie 1976); Arizona: ARIZ. REV. STAT. §§ 42-136, -227 (West Supp. 1977); Arkansas: ARK. STAT. ANN. §§ 84-479 to -480 (Bobbs-Merrill Supp. 1975); California: CAL. CONST. art. XIII, § 8; CAL. GOV'T CODE §§ 51200-51205, CAL. REV. & TAX. CODE §§ 421-429 (Deering Supp. 1977); Colorado: COLO. REV. STAT. §§ 137-1-3(5) to -3(6) (Michie 1973); Connecticut: CONN. GEN. STAT. §§ 7-131a to -131n, 12-107a to -107f, -504a to -507h (1977); Delaware: DEL. CONST. art. 8, § 1 (Because of technical errors in the passage of this amendment, it may be defective); Florida: FLA. CONST. art. 7, § 4; FLA. STAT. ANN. §§ 193.461 (Preferential Assessment for Agricultural Land), .501 (Recreation Land Restrictive Agreement) (West Supp. 1977); Hawaii: HAW. REV. STAT. §§ 246-12, -12.3 to .4 (Dedication Program), -10 (Deferral Program) (Supp. 1975); Idaho: IDAHO CODE ch. 2 § 63-202 (Supp. 1976); Illinois: ILL. CONST. art. 9, § 4(b); ILL. ANN. STAT. ch. 120, §§ 501(a)(1)-501(a)(3) (Smith-Hurd Supp. 1977); Indiana: IND. CODE ANN. § 6-1.1-4-13 (Burns Supp. 1977); Iowa: IOWA CODE ANN. §§ 384.1, 444.21, 441.22 (West Supp. 1976); Kentucky: KY. CONST. § 172A; KY. REV. STAT. ANN. §§ 132.010, .190-.200 (Baldwin 1976); Louisiana: LA. CONST. art. VII, § 18(c); LA. REV. STAT. ANN. §§ 47.2301-.2309 (West Supp. 1977); Maine: ME. CONST. art. IX, § 8; ME. REV. STAT. tit. 36, §§ 1101-1118 (West Supp. 1977); Maryland: MD. CONST. art. 15, art. 43; MD. ANN. CODE art. 81, § 19(b) (Michie Supp. 1976); Massachusetts: MASS. CONST. art. XCIX; MASS. ANN. LAWS ch. 61A, §§ 1-24 (Michie/Law Co-op. 1977); Michigan: MICH. COMP. LAWS §§ 554.701-.719 (MICH. STAT. ANN. §§ 26.1287(1)-.1287(19) (Callaghan Supp. 1976)); Minnesota: MINN. STAT. ANN. §§ 273.111 (Preferential Assessment for Agricultural Lands), .112 (Golf Course and Ski Area Program) (West Supp. 1976); Missouri: MO. ANN. STAT. §§ 137.017-.026 (Vernon Supp. 1976) Montana: MONT. REV. CODES ANN. §§ 84-401, -429.12, -437.1 to .17 (Smith 1974 & Supp. 1976); Nebraska: NEB. CONST. art. 8, § 1; NEB. REV. STAT. §§ 77-1343 to -1346 (Supp. 1974); Nevada: NEV. REV. STAT. §§ 361.325, 361A.010-.160 (Assessment of Agricultural Property), .170-.250 (Assessment of Open-Space Property) (1975); New Hampshire: N.H. CONST. art. 5-B; N.H. REV. STAT. ANN. §§ 79A:1-.14 (Curative Taxation), :15-.21 (Discretionary Easements) (Supp. 1975); New Jersey: N.J. CONST. art. 8, § 1(1); N.J. STAT. ANN. §§ 54:4-23.1 to .23 (West Supp. 1977); New Mexico: N.M. CONST. art. VIII, § 1; N.M. STAT. ANN. § 72-29-9 (Smith Supp. 1975); New York: N.Y. AGRIC. & MKTS. LAW §§ 300-307 (Land in Agricultural Districts) (McKinney Supp. 1976); North Carolina: N.C. GEN. STAT. §§ 105-277.2 to .7 (Michie Supp. 1975); North Dakota: N.D. CENT. CODE § 57-02-27 (Smith Supp. 1973); Ohio: OHIO CONST. art. II, § 36; OHIO REV. CODE ANN. §§ 5713.30-.39 (Page Supp. 1976); Oklahoma: OKLA. CONST. art. X, § 8; OKLA. STAT. ANN. tit. 68, § 2427 (West Supp. 1976); Oregon: OR. REV. STAT. §§ 308.345-.403, 215.203-.263 (1975); Pennsylvania: PA. CONST. art. 8, § 2; PA. STAT. ANN. tit. 16, §§ 11941-11947; tit. 72, §§ 5490.1-.13 (Purdon Supp. 1977); Rhode Island: R.I. GEN. LAWS §§ 44-27-1 to -6, -5 to 12, -39 to -41 (1970); South Carolina: S.C. CODE §§ 65-1605.1 to .2 (Michie Supp. 1975) *as amended by Act 750, 1976 S.C. Acts*; South Dakota: S.D. CONST. art. VIII, § 15; S.D. COMPILED LAWS ANN. §§ 10-6-31 to -36 (Smith Supp. 1976); Tennessee: TENN. CODE ANN. §§ 67-650 to -658 (Bobbs-Merrill 1976); Texas: TEX. CONST. art. VIII, § 1-d; Utah: UTAH CONST. art. XIII, § 3; UTAH CODE ANN. §§ 59-5-87 to -105 (Smith Supp. 1977); Vermont: VT. STAT. ANN. tit. 24, § 2741 (Development Rights Program) (Equity Supp. 1977); Virginia: VA. CONST. art. X, § 2; VA. CODE §§ 58-769.4 to .15:1 (Michie Supp. 1977); Washington: WASH. REV. CODE ANN. § 84.34.010 (Bancroft-Whitney/West Supp. 1976); Wyoming: WYO. STAT. §§ 39-82 (Michie Supp. 1976).

the remaining states, Alabama and West Virginia have so-called classification laws which allow modest preferential treatment of agricultural land.⁶ Kansas and Wisconsin have amended their constitutions and are currently considering differential assessment legislation.⁷

Differential assessment laws are usually categorized as falling into one of three categories: preferential assessment, deferred taxation, and restrictive agreement.⁸ Preferential assessment laws produce an abatement of taxes by authorizing assessors simply to assess eligible land on the basis of farm use value, rather than on market value. Deferred taxation laws add an additional feature and impose a sanction requiring owners of eligible land who convert it to non-eligible uses to pay some or all the taxes which they were excused from paying for a number of years prior to conversion. Restrictive agreement laws include both preferential assessment and, in all states except Vermont, a sanction in the form of a payment of back taxes. In addition, they require the owner to sign a contract spelling out his rights and duties, and preventing him from converting the land to an ineligible use for a specified term of years. In California, for instance, the owner must wait until the end of a ten year run-out period, after signifying his intention of nonrenewal, before he can convert the land to non-eligible uses as of right.⁹

The logic behind differential assessment laws is simple. All across the country, rural land values and tax rates have been rising as urbanization moves out from the city to undeveloped areas.¹⁰ As this occurs, land acquires an increased value over and above its farm use value because it can be used for residential, commercial, and industrial purposes or has a potential for such development. Tax rates rise because the new residents of the rural-urban fringe demand schools, water and sewer systems, roads, police protection, and other public services which were previously unnecessary. Caught in the double crunch of paying taxes at higher rates on land whose market value was rising, farmers and other owners of undeveloped land sought to have

6. ALA. CODE tit. 51, § 17 (Supp. 1973); W. VA. CODE § 11-8-5 (1974).

7. KAN. CONST. art. 11, § 12; WIS. CONST. art. 8, § 1.

8. See, e.g., ECONOMIC RESEARCH SERVICE, U.S. DEP'T OF AGRICULTURE, STATE PROGRAMS FOR DIFFERENTIAL ASSESSMENT OF FARM AND OPEN SPACE LAND (1974); REGIONAL SCIENCE RESEARCH INSTITUTE, UNTAXING OPEN SPACE: AN EVALUATION OF THE EFFECTIVENESS OF DIFFERENTIAL ASSESSMENT OF FARMS AND OPEN SPACE (1976) (prepared for the Council on Environmental Quality) [hereinafter cited as UNTAXING OPEN SPACE].

9. CAL. GOV'T CODE §§ 51244-51246 (Deering 1974 & Supp. 1977).

10. ECONOMIC RESEARCH SERVICE, U.S. DEP'T OF AGRICULTURE, REVISED ESTIMATES OF TAXES LEVIED ON FARM REAL PROPERTY, 1960-73, BULL. NO. 538 (1975).

their land assessed for real property tax purposes at its current or farm use value rather than at its fair market value, which often reflects a substantial developmental value.

In order to set the stage for the analysis which follows, it is necessary to review the basic contextual framework in which differential assessment operates. Farmers are producers of two entirely different classes of goods for two different markets: agricultural commodities and development sites. The common factor joining these two markets is the farmer's land. When used for the production of agricultural commodities, land has a value which is related to its capitalized economic rent as a factor of production. Its economic rent is determined by such factors as soil quality, topography, distance from the market, access to transportation facilities, level of management including drainage, crop rotation and soil conservation practices, general conditions in local, regional, national and international commodity markets, natural conditions such as drought, and so on. The rate at which economic rent is capitalized is a function of property taxes, capitalization rates of competing investment, and investors' expectations concerning appreciation in land values.¹¹

When land is used for residential, commercial or industrial facilities, its value is determined by its proximity to urban development, transportation facilities, areas of special scenic or recreational interest, by conditions in the mortgage markets, by population growth and migration, and, generally, by the demand for new facilities of all types.¹²

In many farming areas, especially those on the rural-urban fringe, there are large differentials between the value of land as an input to the production of agricultural commodities and its value as an input to development. These differentials have produced the crisis which has led to the adoption of differential assessment laws. These laws constitute explicit departures from the uniformity principle found in most state constitutions.¹³

All differential assessment laws are examples of what has come to be known as "tax expenditure," by means of which the tax bills of

11. UNTAXING OPEN SPACE, *supra* note 8, at 5-6.

12. *Id.*

13. Most states have constitutional provisions which mandate uniform taxation. *See, e.g.,* OKLA. CONST. art. X, § 8; WIS. CONST. art. 8, § 1. However, many states have circumvented uniformity of taxation clauses by amending their constitutions to permit preferential treatment of eligible land. CAL. CONST. art. XIII, § 8; DEL. CONST. art. 8, § 1; FLA. CONST. art. 7, § 4; ILL. CONST. art. 9, § 4(b); KY. CONST. § 172A; LA. CONST. art. 7, § 18(C); ME. CONST. art. IX, § 8; MD. CONST. art. 15, art. 43; MASS. CONST. art. XCIX; NEB. CONST. art. 8, § 1; N.H. CONST. art. 5-B; N.J. CONST. art. 8, § 1(1); N.M. CONST. art. VIII, § 1; OHIO CONST. art. II, § 36; PA. CONST. art. 8, § 2; S.D. CONST. art.

some taxpayers are reduced as a result of special tax treatment.¹⁴ Tax expenditures take a variety of forms such as exclusions from the tax base, exemptions, deductions, tax credits, preferential tax rates, and tax deferral.¹⁵ While there are borderline cases in which opinions may differ as to whether a particular item is part of the normal structure or a tax expenditure, there is little question that differential assessment is a classic example of the latter. The effect of a tax expenditure is precisely the same as if the taxpayer who receives the benefit were to pay taxes at the same rate as other, non-preferred taxpayers, and then were to receive a simultaneous grant from the government in the amount of the tax benefit. Thus, there are two ways in which a government can make financial assistance available to a particular class of taxpayers. The first is to tax all taxpayers on the same tax base at the same rate and then make grants in the desired amounts to preferred classes. The second is to structure the tax expenditure system so as to reduce the tax bills of the preferred classes by the same amount. In the first instance, the governmental budget would be increased by the amount of the direct grants to beneficiaries, and the appropriations would be made for this purpose each year. In the second, the payments to them would be made through the tax expenditure structure, where they largely escape annual legislative review. Where tax expenditures exist, they have the effect of shifting the tax burden away from the preferred class to all other taxpayers in an amount equal to the benefits conferred on the preferred class.

I. A SURVEY OF DIFFERENTIAL ASSESSMENT LEGISLATION

A. *Objectives of Differential Assessment Legislation*

As is true of any piece of complex legislation, differential assess-

VIII, § 15; TEX. CONST. art. VIII, § 1-d; UTAH CONST. art. XIII, § 3; VA. CONST. art. X, § 2.

However, in some states which did not make such amendments, differential assessment laws have been held to violate the uniformity clause of the state constitution. *See, e.g., State Tax Comm'n v. Gales*, 222 Md. 543, 161 A.2d 676 (1960). Others, meanwhile, have been upheld against the same allegation. *See, e.g., Bensalem Township School Dist. v. County Comm'rs*, 8 Pa. Commw. Ct. 411, 303 A.2d 258 (1973).

14. *See S. SURREY, PATHWAYS TO TAX REFORM* (1973). Any tax system can be viewed as consisting of two parts. The first establishes the normal structure of the tax by defining the tax base, whether it be taxable income, property or some transaction such as sale, and establishing the rate of, and procedures for collecting, the tax. The second consists of a set of tax benefits which are conferred by the government by means of tax reductions for certain classes of taxpayers, with the objectives of providing incentives for certain kinds of socially desirable activities, easing hardships, or simply favoring politically powerful interest groups. The second part is not necessary to the proper working of the tax structure. *Id.*

15. OFFICE OF MANAGEMENT AND BUDGET, BUDGET OF THE U.S. GOVERNMENT, FISCAL YEAR 1978, SPECIAL ANALYSIS F, TAX EXPENDITURES 119-27 (1977).

ment laws have been enacted to achieve more than one objective. In the analysis in later sections, this Article will examine the effectiveness of such statutes with respect to what appear to be the predominant legislative aims: to provide tax relief for farmers and to preserve open space.¹⁶ It is useful here, however, to review some of the specific public policies which different differential assessment laws have sought to advance.

In some states, the objective appears to be to help the family farmer.¹⁷ In other states, the objective has been to give a tax benefit to all farmland, regardless of ownership, quality of soil or proximity to urban development.¹⁸ Some statutes seek to protect other kinds of open land. California's Williamson Act makes differential assessment available to qualifying land devoted to agricultural, recreational, scenic, wildlife habitat and open space uses.¹⁹ Still other states have established planning and zoning requirements which are designed to limit participation to those tracts of land which are in areas designated for agricultural use in a municipal comprehensive plan.²⁰

These examples serve to illustrate the variety of objectives which differential taxation laws have sought to achieve. Each state's statute must of course be evaluated in terms of its own set of goals.

B. *Characteristics of Differential Assessment Legislation*

1. General

Table 1²¹ summarizes the provisions of state laws granting differ-

16. See notes 61 to 110 and accompanying text *infra*. See also R. Barrows, *Lower Taxes for Farmland and Open Space?*, in Staff Paper No. 84, 17-18 (Univ. of Wis. Cooperative Extension Program 1974).

17. Texas, for instance, requires that the owner must be a natural person, not a corporation, that he be in agriculture for profit and that agriculture be his primary occupation and income source. TEX. CONST. art. 8, § 1-d(a). In addition, the land must have been in agricultural use exclusively and continuously for the three preceding years. *Id.* § 1-d(e). For a discussion of when agriculture is considered a primary occupation, see *Gragg v. Cayuga Independent School Dist.*, 525 S.W.2d 32 (Tex. Civ. App. 1975); *Driscoll Foundation v. Nueces County*, 445 S.W.2d 1 (Tex. Civ. App. 1969).

18. In Indiana, the legislature simply directed assessors to assess land in agricultural use as agricultural land and set no further eligibility criteria. IND. CODE ANN. § 6-1.1-4-13 (1972). This definition has been expanded somewhat by the State Board of Tax Commissioners so that agricultural land is defined as "an area in open country used for producing crops and raising livestock, and whose principal value arises out of such use." All land classified by the assessor is automatically awarded preferential assessment. STATE BD. OF TAX COMM'RS., INDIANA REAL PROPERTY APPRAISAL MANUAL at F 1 (1968).

19. CAL. GOV'T CODE §§ 51201, 51231, 51238 (Deering 1974).

20. See, e.g., OR. REV. STAT. §§ 215.203, 215.213 (1975).

21. Table I is the chart on the following pages.

Table 1* (cont.)

Deferred Taxation

Restrictive Agreements

	Minnesota 2	Montana	Nebraska	Nevada	New Hampshire 1	New Jersey	New York 1	New York 2	North Carolina	Ohio	Oregon	Pennsylvania 1	Pennsylvania 2	Rhode Island	South Carolina	Tennessee	Texas	Utah	Virginia	Washington	California	Florida 2	Michigan	New Hampshire 2	Vermont
Year of Enactment	69	73	74	75	72	64	71	71	73	74	63	66	74	68	75	76	66	69	71	70	65	67	74	73	69
Eligible Uses																									
Agriculture																									
Open Space, Envir. Protection																									
Timber or Forest																									
Recreation																									
Additional Eligibility Requirements																									
Min. Farm Income Required																									
History of Eligible Use Required																									
Min. Length of Tenure w/in Family																									
Land Must be Planned for Eligible Use																									
Land Must be Zoned for Eligible Use																									
Sanctions on Conversion																									
Rollback Taxes Collected (no. of yrs.)	7	4	5	7	2	5	5	5	5	4	10	5	7	2	5	3 $\frac{1}{2}$	3	5	5	7		*	7		
Interest on Deferred Taxes																									
Penalty Based on Mk. Val. in Yr. of Conversion																									
Other Penalty																									
Restrictive Agreements																									
Min. Length of Term (no. of yrs.)																									
Scope of Program																									
Statewide																									
Local Option																									
Voluntary, Requires Application																									
Automatic for Eligible Lands																									
State Subvention Payments Provided To																									
Offset Revenue Loss																									

● Indicates that there is a total rollback of deferred taxes.

* Table 1-and the accompanying notes cannot replace careful consideration of each individual statute. Since there do not appear to be widely-copied model or leading statutes in this area of the law, there are numerous small but important differences in the statutes. The simplification into tabular form has undoubtedly created distortions. The table should be useful in determining such facts as how many states have rollback penalties or what the typical terms of restrictive agreements are. However, it should not be used to try to draw fine comparisons.

+ Michigan grants a tax credit for local taxes which exceed 7% of income.

ential assessment to agricultural and open lands which had been enacted as of June, 1977. This data was assembled from two excellent earlier studies,²² information supplied by tax officials in the fifty states and staff research.

The state programs identified in Table 1 are listed alphabetically under the classifications: pure preferential assessment, deferred taxation or restrictive agreement. Some states have more than one program, and these are listed separately. The table is accompanied by explanatory notes.

For the purposes of classification, a strict definition of restrictive agreement is used in this Article. The programs in Hawaii,²³ Louisiana,²⁴ New York,²⁵ Pennsylvania²⁶ and Washington²⁷ are classified as deferred taxation programs even though they require the landowner to commit his land to the eligible use for a specified number of years. This is done because the agreements are not enforced. As long as the landowner in these states pays the rollback tax²⁸ and any other penalties, he may change the use of his land without petitioning for release from the agreement.

Table 1 specifically excludes three widespread forms of legislation which have the effect of reducing the tax burden on specified open lands: state open space easement enabling statutes, forest taxation laws and classified property tax systems.

Many states have enacted open space easement laws which authorize municipalities to acquire interests in open land for the purposes of preserving open space.²⁹ Once an owner has conveyed such an

22. R. GLOUDEMANS, *USE VALUE FARMLAND ASSESSMENTS I* (1974) (emphasizes the evaluation of the operation and impact of differential assessment laws on tax base and land use); ECONOMIC RESEARCH SERVICE, U.S. DEP'T OF AGRICULTURE, *STATE PROGRAMS FOR DIFFERENTIAL ASSESSMENT OF FARM AND OPEN SPACE LAND* (1974) (contains a detailed state by state review of provisions).

23. HAW. REV. STAT. §§ 246-10 to -63 (Supp. 1975).

24. Act No. 702, 1976 La. Acts.

25. N.Y. AGRIC. & MKTS. LAW §§ 300 to 307 (McKinney Supp. 1976).

26. PA. STAT. ANN. tit. 16, §§ 11941-11947; tit. 72, §§ 5490.1-.13 (Purdon Supp. 1977).

27. WASH. REV. CODE ANN. §§ 84.34.010-.34.921 (Bancroft-Whitney West Supp. 1976).

28. See notes 94-106 and accompanying text *infra* for an explanation of the rollback tax.

29. See, e.g., CAL. GOV'T CODE §§ 51050-51065, 51070-51073 (Deering 1974 & Supp. 1977); CONN. GEN. STAT. §§ 7-131a to -131m (1977); MD. NAT. RES. CODE ANN. §§ 5-1201 to -1219 (Michie Supp. 1977); OR. REV. STAT. § 271.710-750 (1975); PA. STAT. ANN. tit. 32, §§ 5001-5013 (Purdon Supp. 1977).

interest, his property is assessed at its market value minus the value of the rights and interests surrendered. In practical effect, there is little difference between the conveyance of an open space easement for a term of years and entering into a restrictive agreement for a like term. Conceptually, however, there is no preferential assessment of land in the first case because the assessor is simply assessing the remaining property interests on the basis of their fair market value. Because of this fact, open space easement programs have not been included in this study.

Forest and timber taxation laws generally set the annual assessment of eligible forest or timber lands at a very low level and provide for a yield tax at time of harvest.³⁰ While the goals of these laws, giving a tax break to the forest products industry and promoting conservation of forest resources, overlap somewhat with the goals of the use-value assessment statutes discussed here, they raise a set of issues which are outside the scope of this Article.

Seven states have enacted classified property tax systems which mandate different assessment-market price ratios for specified classes of real property.³¹ Generally agricultural and residential properties are assigned similar ratios which are lower than the ratios for industrial, commercial, and utility properties. While granting some preferential assessment for open land, these acts do not protect urban fringe land from higher taxes due to rising market values if the ad valorem principle is maintained. The fact that residential and agricultural property are often given the same ratio indicates that agricultural use is not preferentially assessed relative to its major competitor. Because these provisions are not aimed specifically at agricultural and open lands and involve different concepts than the laws discussed here, they have not been included in the table.

2. Notes to Table 1

a. Eligible Uses

Agriculture: The definition of qualifying agricultural uses varies across programs, but is generally quite broad, ranging from requiring land to

30. See, e.g., IND. CODE ANN. §§ 6-1.1-6-1 to 6-1.1-6-27 (Burns Supp. 1977). W. Klemperer, *Evaluating Forest Tax Alternatives for Oregon* (Oregon Legislative Interim Committee on Revenue 1975); L. Hargreaves & R. Jones, *Forest Property Taxation*, Report No. 29 (Georgia Forest Research Council 1972).

31. Alabama: ALA. CODE tit. 51 § 17 (1958); Arizona: ARIZ. REV. STAT. § 42.136 (West Supp. 1977); Louisiana: LA. CONST. art. VII, § 18B; Minnesota: MINN. STAT. ANN. § 273.112 (West Supp. 1976); South Carolina: S.C. CODE § 65-1648 (Supp. 1975); Tennessee: TENN. CODE ANN. § 67-611 (Bobbs-Merrill 1976); West Virginia: W. VA. CODE § 11-8-5 (1974).

lay fallow for one year as a regular requirement of good agricultural husbandry³² to requiring intensive cultivation.³³ Statutes usually provide that associated waste and wooded land is considered an agricultural use,³⁴ but improvements on such land generally are not within the statutory definition of agriculture.³⁵

Open Space, Environmental Protection: The definition of these lands is broad, but eligibility is usually contingent on approval by a public body.³⁶ Critical natural, scenic, and historical resources are usually included in the list of eligible lands.³⁷

Timber or Forest: While several states³⁸ include this as an eligible use, many also have forest taxation laws which provide greater benefits to landowners.³⁹

Within the statutes listed here, the intent behind the preferential taxation of forest land may be different from that behind the preferential taxation of timber land, with the latter implying benefits to harvesters and the former a reward for resource conservation. However, such distinctions are not apparent on the face of most statutes and the words seem to have been used interchangeably to refer to heavily wooded land. In several cases the eligibility of these lands hinges on the approval of a state official, such as the State Forester.⁴⁰

Recreation: These provisions are designed to benefit country clubs, golf courses, ski areas, hunting grounds, and other recreational facilities.

b. Additional Eligibility Requirements

Minimum Farm Income Required: This is typically worded in terms of

32. See, e.g., Oregon: OR. REV. STAT. § 215.203-2b (1975).

33. See, e.g., N.J. STAT. ANN. § 54:4-23.3 (West Supp. 1977). See *City of E. Orange v. Township of Livingston*, 102 N.J. Super. 512, 246 A.2d 178 (1968), *aff'd.*, 54 N.J. 96, 253 A.2d 546 (1969); *cf.*, *Andover Township v. Krymer*, 140 N.J. Super. 399, 356 A.2d 418 (1976) (entire tract entitled to tax assessment on farmland despite the fact that only 100 acres of tract actually being farmed).

34. See, e.g., ME. REV. STAT. tit. 36, § 1102 (West Supp. 1976).

35. See, e.g., MASS. ANN. LAWS ch. 61A § 1 (Michie/Law. Co-op. Supp. 1977).

36. See, e.g., OKLA. STAT. ANN. tit. 68, § 2427 (West Supp. 1976); WASH. REV. CODE ANN. § 84.34.010-.34.050 (Bancroft-Whitney/West Supp. 1976).

37. See, e.g., Mich. Comp. Laws §§ 554.701-.719 (MICH. STAT. ANN. §§ 26.1287(1)-1287(19) (Callaghan Supp. 1976)).

38. See, e.g., DEL. CODE ANN. tit. 9 §§ 8329-8331 (1974 & Supp. 1976); MO. ANN. STAT. § 137.017 (Vernon Supp. 1976); N.M. STAT. ANN. § 72-29-9 (Smith Supp. 1975).

39. See, e.g., *The Western Oregon Ad Valorem Timber Tax Law*, OR. REV. STAT. § 321.605-680 (1975). See also note 30 *supra*.

40. See, e.g., IND. CODE ANN. §§ 6-1.1-6-1 to 6-1.1-6-27 (Burns Supp. 1977).

a minimum required level of gross annual receipts with an additional amount per acre in some cases. Some states require that the owner must satisfy one or the other of these provisions, a requirement designed to make speculators ineligible while including low-income subsistence farmers.⁴¹

History of Eligible Use Required: In these programs, the land must have been in the eligible use for a number of years prior to application, typically two years.⁴²

Minimum Length of Tenure Within Family: Programs listed here require that the land has been owned by the applicant's family for a period of years. In North Carolina and Minnesota, this is seven years, unless, in the latter, the applicant lives on the property.⁴³

Land Must Be Planned or Zoned for the Eligible Use: These provisions, which link preferential assessment to the land use planning process, are rarely included in state statutory schemes. When they are, their strictness and effectiveness vary greatly among the states. In most of these programs, a use must be allowed under the zoning ordinance to be eligible,⁴⁴ but there is no provision that other uses could not be allowed under the zoning category. Several states terminate eligibility when the owner applies for a zoning change or files a subdivision plan.⁴⁵ Connecticut⁴⁶ and Washington⁴⁷ have planning requirements for lands in the "open space" category but not for farmland.

c. Sanctions on Conversion

While most penalties are assessed on conversion of the land to a non-qualifying use, a few states assess the penalty either then or at time of sale. Many programs specifically require notifications of

41. For instance, the Pennsylvania provision mandates that in order for land to be considered to be in agricultural use, it must meet one of several requirements including that "[s]uch land was devoted to agricultural use the preceding three years and is not less than ten contiguous acres in area or has an anticipated yearly gross income of two thousand dollars." PA. STAT. ANN. tit. 72, § 5490.3(a)(1) (Purdon Supp. 1977); see MO. ANN. STAT. § 137.017 (Vernon Supp. 1976); MONT. REV. CODES ANN. § 84-437.2 (Smith Supp. 1976); S.D. COMPILED LAWS ANN. §§ 10-6-31 to -33.5 (Smith Supp. 1977).

42. See, e.g., N.J. STAT. ANN. § 54:4-23.2 (West Supp. 1977); OHIO REV. CODE ANN. § 5713.30 (Page Supp. 1976); UTAH CODE ANN. § 59-5-87 (Smith Supp. 1977).

43. MINN. STAT. ANN. § 273.111 subd. 3 (West Supp. 1976); N.C. GEN. STAT. § 105-277.3(b)(2) (Michie Supp. 1975).

44. See, e.g., OR. REV. STAT. §§ 215.203, 215.213 (1975).

45. See, e.g., MD. ANN. CODE art. 81, § 19(b) (Michie Supp. 1976).

46. CONN. GEN. STAT. § 12-107b(c) (1977).

47. WASH. REV. CODE ANN. § 84.34.020 (Bancroft-Whitney/West Supp. 1976).

changes in use,⁴⁸ and some provide additional penalties for failing to do so.⁴⁹

Rollback Taxes Collected: These are usually calculated as the difference between the taxes that would have been due at market value assessment and the taxes actually paid under the program, summed over the number of specified years.⁵⁰ For administrative simplicity, several states have changed this to a multiple of the difference between market and use-value taxes in the year of conversion.⁵¹ In a market with rising property values, this will produce a larger rollback.

Interest on Deferred Taxes: The interest rates range from 5% to 10% and are usually not compounded. Michigan has compound interest for early termination.⁵²

Penalty Based on Market Value in Year of Conversion: This is a specified percentage of sale price or market value at conversion.

Other Penalty: For withdrawal before a specified number of years, some states levy an additional penalty, such as a certain percentage of the deferred taxes.⁵³

d. Restrictive Agreements

Minimum Length of Term: While the length of the term is negotiable in most states, four out of the five states set a minimum length of term.⁵⁴

e. Scope of Program

A program is considered statewide if local assessors or governing bodies have no choice in the acceptance of applications from lands that meet the statutory eligibility requirements. In a very few cases, the laws apply only to specified parts of the state.⁵⁵

48. See, e.g., ILL. ANN. STAT. ch. 120, § 501a-2, para. 3 (Smith-Hurd Supp. 1977).

49. See, e.g., OR. REV. STAT. § 308.395(2)(C) (1975). If the owner converts the land to an ineligible use without notifying the assessor, he must pay a penalty equalling 20% of the deferred taxes.

50. See, e.g., FLA. STAT. ANN. § 193.501(4) (West Supp. 1977); N.J. STAT. ANN. § 54:4-23.8 (West Supp. 1977).

51. See, e.g., MD. ANN. CODE art. 81, § 19(b)(2)(a)(i) (Michie Supp. 1976); MICH. COMP. LAWS § 554.701 (MICH. STAT. ANN. § 26.1287(12)(4) (Callaghan Supp. 1977)); N.H. REV. STAT. ANN. § 79A:19(I) (Supp. 1975).

52. MICH. COMP. LAWS § 554.701 (MICH. STAT. ANN. § 26.1287 (1) (Callaghan Supp. 1977)).

53. See, e.g., WASH. REV. CODE ANN. §§ 84.34.070, .080, .090, .100 (Bancroft-Whitney/West Supp. 1976).

54. CAL. GOV'T CODE § 51244 (Deering Supp. 1977); FLA. STAT. ANN. § 193.501 (West Supp. 1977); MICH. COMP. LAWS § 554.704 (MICH. STAT. ANN. § 1287(4) (Callaghan Supp. 1977); VT. STAT. ANN. tit. 24, § 2741 (Equity Supp. 1977).

55. Pennsylvania's first differential assessment statute, for instance, limited its

In the voluntary programs, applications are required initially, and in some cases annually.⁵⁶ In the automatic programs, assessment regulations for all specified lands are state mandated.⁵⁷

f. State Subvention Payments

State payments to offset the revenue loss attributable to differential assessment are provided under only three programs.⁵⁸ In California, these are tied either to the estimated tax loss or the acres of land in the program, whichever is the lesser amount.⁵⁹ In New York, subventions are provided only when the state initiates an agricultural district, which has not happened to date.⁶⁰

II. EFFECTIVENESS FOR PROVIDING TAX BENEFITS TO FARMERS AND OTHER OWNERS OF ELIGIBLE LAND

A. *General Considerations*

As already indicated, a primary goal of differential assessment is to reduce the real property taxes of farmers and other owners of eligible land.⁶¹ In many states, this appears to have been the only, or at least, the overriding goal. In any case, the other goals, such as retarding the conversion of open land to urban uses, the securing of recreational benefits, the protection of scenic resources, and the controlling of urban development, all depend on the magnitude of the tax benefit. The larger it is, the more likely it is, so the argument goes, that owners of undeveloped land will be induced to hold the land off the market and maintain it in its current use.⁶² This section of the Article examines the effectiveness of differential assessment by examining the tax benefits which result and how they are affected by various types of programs.

The analysis which follows will, for purposes of simplification, focus on farmers and farmland. Farmers are the primary beneficiaries

coverage to urban areas as defined by the census. PA. STAT. ANN. tit. 16, §§ 11941-11947 (1968). However this provision was removed in 1972.

56. See, e.g., ALASKA STAT. § 29.53.035(b) (Michie 1976); HAW. REV. STAT. § 246-10(a) (Supp. 1975).

57. See, e.g., ARIZ. REV. STAT. §§ 42-136, -227 (West Supp. 1976); IDAHO CODE ch. 2 § 63-202 (Supp. 1976); IND. CODE ANN. § 6-1.1-4-13 (Burns Supp. 1976).

58. ALASKA STAT. § 29.53.035(e) (Michie 1976); CAL. GOV'T CODE §§ 16100-70 (Deering 1973 & Supp. 1977); N.Y. AGRIC. & MKTS. LAW § 305(1)(f) (McKinney Supp. 1976).

59. CAL. GOV'T CODE §§ 16100-70 (Deering 1973 & Supp. 1977).

60. N.Y. AGRIC. & MKTS. LAW § 305(b) (McKinney Supp. 1976).

61. See notes 4 & 5 and accompanying text *supra*.

62. M. BENNETT & J. CLARK, RECOMMENDATIONS FOR IMPLEMENTING PENNSYLVANIA'S NEW FARMLAND AND FOREST LAND ASSESSMENT ACT 10 (1975).

of most differential assessment laws, and in almost every case factors affecting tax savings for them will be similar to factors affecting owners of timber, recreational, scenic and other types of undeveloped land. Where different considerations come into play for these latter classes of land, they will be noted.

The tax benefits which owners receive as a result of differential assessment of land are measured by the difference between those taxes which they would pay if they did not participate in the program and those which they pay as participants. In evaluating the effectiveness of a particular type of differential assessment program it is therefore essential to understand the context within which it operates. This context can be best analyzed in terms of the interaction between rural land market factors and property tax factors.

1. Land Market Factors and Property Tax Factors

Agricultural land is sold in two types of markets: the market for land to be used to produce agricultural products and the market for development sites.⁶³ The first type exists in its purest form in rural areas remote from the pressures of urbanization, where agriculture is the highest bidding use. The second exists in suburban areas where little farming occurs. In between, in the rural-urban fringe, the two markets overlap, so that some land is sold for agricultural use, and some for development, but at intermediate prices.

a. Remote Rural Areas

In remote rural areas, land values are a function of the annual economic surplus (or net income) which a reasonably able farmer estimates he can generate from the land, the capitalization rate a prudent farmer assigns to this surplus (or to state it differently, the rate of return which he will demand from his investment), and the effective property tax rate for the taxing jurisdiction in which the farm is located.⁶⁴ In such areas the property tax is based on agricultural use value and therefore is a percentage of net income from the land.⁶⁵

63. See text accompanying notes 10-11 *supra*.

64. See generally Back, *Land Value Taxation in Light of Current Assessment Theory and Practice*, in *THE ASSESSMENT OF LAND VALUE* 37 (D. Holland ed. 1970).

65. Where agriculture is the highest bidding use (or the "highest and best use"), land value, V, will be a function of the net farm income, Y, the capitalization rate, C, and the effective property tax rate, R. This relationship is expressed as follows:

$$V = \frac{Y}{C + R}$$

However, the impact of the tax is reduced because it is a deductible item for federal income tax purposes.⁶⁶

b. The Rural-Urban Fringe

In the second type of market, where pressures from urban development are at work, land values are bid up by buyers who will pay more than the land is worth for agricultural use because they, in turn, can develop it and sell it at a higher price to homebuyers and businesses. The difference between farm use value and fair market value for development is the development value of the land. In the absence of a differential assessment law or similar legislation, property tax assessors are mandated to appraise land at its fair market value, including both agricultural use value and development value.

As a result, assuming no *de facto* preferential assessment (where assessors improperly hold appraised value at agricultural use value levels), appraised values will rise as development values increase. The farmer's taxes increase correspondingly, even though his net income from agricultural activity remains at essentially the same level, all other things being equal. The taxes, which are no longer related to his net income attributable to farming, become a larger and larger component of his costs, sometimes rising to the point where they equal or exceed his net income before property taxes. The farmer may then be caught in a classic income squeeze and may start to look for a buyer. Differential assessment laws are designed to alleviate this squeeze by

In areas where agriculture is the highest bidding use, the appraised values which property tax assessors use to establish the tax base should, in principle, be the agricultural use value, and in such cases, the dollar value of the tax on the land, T, is:

$$T = R V$$

Substituting for V,

$$T = \frac{RY}{C + R}$$

We may now express T as a proportion of the net farm income, Y, to obtain the tax rate on the net income from farming, P:

$$P = \frac{T}{Y}$$

Substituting terms and simplifying,

$$P = \frac{\frac{RY}{C + R}}{Y} = \frac{R}{C + R}$$

Thus, for all levels of net income, the tax rate, P, on the net income is determined by the magnitudes of the real property tax rate, R, and the capitalization rate, C.

66. I.R.C. § 164(a)(1).

authorizing assessors to re-appraise eligible land according to its agricultural value and thereby re-establish net agricultural income as the basis of the real property tax.

2. The Effect of Market and Property Tax Factors on Tax Savings

There are three factors relating to the land market and the real property tax system in a particular landowner's taxing jurisdiction which influence the magnitude of the tax benefits he might receive from differential assessment.

The first factor is the difference between the assessed value of the land based on fair market value and its assessed value based on current-use or farm value. Obviously, farmers at the rural-urban fringe would, in principle, enjoy the largest reduction, although the fact that *de facto* preferential assessment of farmland is widespread in these areas may, in practice, reduce the magnitude of the benefit. In these areas, differential assessment would protect the farmer against future increases in tax burden resulting from rising land value and reassessment.

The second factor is the percentage which the assessed value of farm land and associated real estate improvements, such as barns, throughout the taxing jurisdiction, is of the total assessed value tax base before the establishment of differential assessment. If all realty in the jurisdiction is in eligible agricultural use, there would be no benefit to an individual farmer. The assessed value of his land would be reduced, but since the tax revenue needs of the municipality would remain the same, his tax rate would go up by an amount sufficient to produce the same tax revenue, and his tax bill would remain unchanged. At the other extreme, if there is a very small amount of eligible land in a jurisdiction, the tax saving for its owner would be proportional to the reduction in assessment. This matter is fully discussed below.

The third factor is the percentage which the assessed value of the improvements on a particular farm is of its total assessed value before differential assessment. The tax benefit usually involves only taxes on land, and improvements continue to be assessed at fair market value. In general, if an individual owner is to be better off after the institution of a differential assessment program, the percentage of his farm's value which is in eligible land must be at least as large as the percent of the entire tax base which is in eligible land. Thus, not all farmers will enjoy a net benefit from a differential assessment program. Those with a high proportion of improvement value to land value may see their tax bills rise, even though their land is assessed at a lower rate.

B. *Program Factors and the Provision of Tax Benefits*

For a given configuration of rural land market and property tax factors, the tax benefits a landowner receives will be determined by a third set of variables. These are the "program factors" established by the relevant differential assessment legislation and associated administrative regulations and practices which determine eligibility, method of assessment, sanctions, and so forth.

The three principal forms of differential assessment, preferential assessment, deferred taxation and restrictive agreements, can be viewed most usefully as sets of progressively more restrictive provisions, variations of which have been used by different states. Thus, all differential assessment laws grant preferential assessment. To evaluate this technique, this section of the Article will examine the major types of eligibility criteria, methods of assessment and non-tax benefits which different states have included in their laws, to see how they expand or contract eligibility and increase or decrease tax benefits. Most states have added rollback provisions to capture some or all of the taxes deferred.⁶⁷ In addition, this section analyzes how variations in rollback taxes affect the achievement of the goal of making tax benefits available to farmers. Finally, five states have added a legal sanction to the economic one of deferred taxation and have required eligible owners to sign long-term restrictive agreements which tie up their land for a specified period.⁶⁸ These provisions also will be examined in light of their effect on the achievement of the above goals.

The analysis which follows will start with provisions of differential assessment laws which provide the greatest tax benefits and the most attractive programs for farmers and examine how other provisions successively narrow the class of eligible land and reduce the total tax benefits conferred on the class of eligible owners.

1. Preferential Assessment

a. Eligibility Criteria

The best example of a law with broad eligibility criteria is Indiana.⁶⁹ There, all land which is devoted to agricultural use is to be assessed as

67. See, e.g., ALASKA STAT. § 29.53.035(a) (Michie 1976); MD. ANN. CODE art. 81, § 19(b)(1) (Michie Supp. 1976); N.J. STAT. ANN. § 54:4-23.8 (West Supp. 1977).

68. CAL. REV. & TAX. CODE §§ 421-429 (Deering 1975 & Supp. 1977); FLA. STAT. ANN. § 193.501 (West Supp. 1977); MICH. COMP. LAWS § 554.701-.719 (Mich. Stat. Ann. §§ 26.1287(1)-1287(19) (Callaghan Supp. 1977); N.H. REV. STAT. ANN. §§ 79A:15-21 (Supp. 1975); VT. STAT. ANN. tit. 24, § 2741 (Equity Supp. 1977).

69. IND. CODE ANN. § 6-1.1-4-13 (Burns Supp. 1976).

agricultural land. The local assessor makes the determination as to whether land is in agricultural use, and once it is so classified, it automatically receives preferential assessment.⁷⁰ Thus, all farmland in the state receives preferential assessment.

Several states have enacted additional criteria which limit eligibility.⁷¹ Their primary goal has been to exclude speculators and other non-farmers from the benefits of the program.⁷² A few states require that the owner must receive a certain amount of gross income per acre or a minimum percentage of his income from the land.⁷³ In many states, it is necessary for the owner to apply for differential assessment.⁷⁴ This may be a fairly simple procedure with automatic renewal from year to year, or it may involve the preparation of a survey, the submission of plat plans, and the payment of a substantial fee, as in California.⁷⁵ In some states, such as North Carolina, it is necessary to review the application every year.⁷⁶ Eligibility is further limited by some states which have prescribed planning and zoning requirements designed to limit participation to those properties which have been designated in a plan as open space or have been zoned for that purpose.⁷⁷

Florida's preferential assessment law has two interesting eligibility provisions. One allows a board of county commissioners to deny eligibility to lands which are contiguous to urban or metropolitan development where the board finds that "the continued use of such lands for agricultural purposes will act as a deterrent to the timely and orderly expansion of the community."⁷⁸ The second creates a rebutt-

70. STATE BD. OF TAX COMM'RS, INDIANA REAL PROPERTY APPRAISAL MANUAL at F 1 (1968).

71. COLO. REV. STAT. § 137-1-3(6)(a)(i) (Michie 1973) (history of eligible use); DEL. CODE ANN. tit. 9, §§ 8329-8331 (1974) (history of eligible use); DEL. CODE ANN. tit. 9, § 8333 (1974) (minimum farm income); MO. ANN. STAT. § 137.017 (Vernon Supp. 1977) (minimum farm income).

72. For instance, Texas requires that the owner must be a natural person whose farm business is his primary occupation and source of income. TEX. CONST. art. VIII, §§ 1-d(a), (e).

73. See, e.g., MONT. REV. CODES ANN. § 84.437.2(b) (Smith Supp. 1976); PA. STAT. ANN. tit. 72, § 5490.3(a)(1) (Purdon Supp. 1977).

74. E.g., ARK. STAT. ANN. § 84-484(A) (Bobbs-Merrill Supp. 1975); N.J. STAT. ANN. § 54:4-23.1 (West Supp. 1977); PA. STAT. ANN. tit. 16, § 11943 (Purdon Supp. 1977).

75. CAL. GOV'T CODE § 51248 (Deering Supp. 1977); UNTAXING OPEN SPACE, note 8 *supra*, at 294.

76. N.C. GEN. STAT. § 105-277.4(a) (Michie Supp. 1975).

77. See, e.g., CAL. GOV'T CODE § 51230 (Deering Supp. 1977); OR. REV. STAT. §§ 215.203, .213 (1975). In California, land must be in an agricultural preserve so designated in a general plan and must be suitably restricted by zoning or some other means to permissible uses within two years thereafter.

78. FLA. STAT. ANN. § 193.461(4)(b) (West Supp. 1977).

able presumption that land which sells for three or more times the agricultural assessment placed on the land is not used primarily for agricultural purposes.⁷⁹

For several reasons, there is no way of determining empirically what percentage of otherwise eligible land in a given state will be excluded by a particular eligibility criterion. First, most states do not have an accurate inventory of land in agricultural or other eligible uses, so that the universe of potentially eligible land is not well-defined. Second, owners may be receiving substantial *de facto* preferential assessment, so that they have little incentive to enroll. Third, an owner who contemplates development in the near future may not think it worthwhile to enroll. Fourth, no data are available on an aggregate basis concerning such factors as years in agricultural use, gross income per acre, length of ownership, acreage owned by corporations, or owner's income, which would allow one to determine how many acres of land were rendered ineligible because of failure to meet a particular criterion. Thus, we are left with the simple argument based on the logic that the more eligibility criteria there are, the smaller will be the percentage of farmers who actually enroll in the program and receive tax benefits.

b. Methods of Assessment: The Magnitude of the Tax Benefit

In evaluating the effectiveness of differential assessment for conferring tax benefits, it is necessary to examine not only the inclusiveness of eligibility criteria, but also the magnitude of the assessment differential which an eligible farmer is accorded. This, in turn, is influenced by the method used by assessors to re-establish agricultural net income as the primary determinant of appraised value and, consequently, of assessed value and property tax burden.

To determine agricultural use value, assessors may use one of three basic methods. One is to estimate value directly based on data on comparable sales.⁸⁰ A second is to estimate the capitalized value which is consistent with the agricultural productivity of the land and a commonly accepted capitalization rate.⁸¹ The third involves the use of land value tables which have been constructed on the basis of soil productivity ratings.⁸²

79. *Id.*

80. California's Williamson Act permits assessors to use comparable sales data, but only if they can show by convincing evidence that the use restriction imposed by the restrictive agreement will be removed in the predictable future. CAL. REV. & TAX. CODE § 423 (Deering Supp. 1977). This has meant, in practice, that such data are not used.

81. *See, e.g.*, OR. REV. STAT. § 308.345(3) (1975).

82. Maryland's Department of Assessment and Taxation has prepared a table which

The comparable sales method of appraisal derives the fair market value of one property from recent sales data of other properties with similar location, accessibility, productivity, size, and so on. Such a method is often not appropriate for farm use value appraisal because the other sales prices often are significantly affected by development value. Most of the states studied in detail do not use comparable sales.

Where the capitalization of income approach is used, assessors normally attempt first to determine income by looking at rental data to determine what rent a particular tract could be expected to bring.⁸³ If reliable rental information is not available, assessors will estimate the income which the land can be reasonably expected to yield under prudent management, after deducting appropriate operating expenses and capital charges.⁸⁴

Capitalization rates vary considerably from state to state, and from year to year, because they are often set administratively in accordance with legislative criteria.⁸⁵ The capitalization rate in 1975 was 5% in Maryland,⁸⁶ 8% in Oregon,⁸⁷ 8.5% in Washington⁸⁸ and 10% in New Jersey.⁸⁹ Effective tax rates on agricultural land (the percentage which the tax is of fair market value) generally range between 1% and 2.75%, so that income from the land may be capitalized at a rate varying from 7% or 8% to 11% or 12%.

Several analysts have noted that capitalization rates expected by buyers of agricultural land are usually in the 2% to 4% range. These

classifies soil into six classes and assigns a full market value to each one. *See* UNTAXING OPEN SPACE, note 8 *supra*, at 38.

83. However, in many areas, such as New Jersey, rental values are distorted by the very existence of differential assessment. Investors and developers often are willing to rent out land to a nearby farmer for little more than the real property taxes attributable to the land, so as to qualify it as agricultural land in order to obtain the benefits of differential assessment. Observed rents in such situations may bear little relationship to the net income attributable to the land in agricultural use.

84. *E.g.*, CAL. REV. & TAX. CODE § 423 (Deering Supp. 1977); UNTAXING OPEN SPACE, *supra* note 8, at 274-79.

85. For instance, in California, the State Board of Equalizations must fix the rate each year at the level of the yield rate for long term United States Government bonds as most recently published by the Federal Reserve Board. CAL. REV. & TAX. CODE § 423 (Deering Supp. 1977). In Oregon, the Department of Revenue sets the rate at "the rate of interest charged by the Farm Credit Administration averaged over the past five years, plus a component for the local tax rate." OR. REV. STAT. § 308.345(3) (1975).

86. *See* UNTAXING OPEN SPACE, note 8 *supra*, at 134.

87. *Id.* at 204.

88. *See* WASH. DEP'T OF REVENUE, PROPERTY TAX BULLETIN 74.14 (1974); UNTAXING OPEN SPACE, note 8 *supra*.

89. UNTAXING OPEN SPACE, note 8 *supra*, at 152.

rates are lower than those demanded by investors in other markets, such as that of commercial realty, largely because there is good reason to expect rural land values to rise at the rate of 5% or more per year, so that net return from the land ranges between 7% and 9%.⁹⁰ A method of assessment which uses a higher than agricultural land market capitalization rate produces current use value which is lower than the "real" use value for which one farmer could sell his land to another. It thus amounts to a preference on top of a preference.

Some states such as Indiana and Maryland, either by statute or by regulation, prescribe values based on soil productivity ratings.⁹¹ Local assessors determine the appropriate average productivity rating for a particular tract and then use the table provided to arrive at estimated true cash value for farm use. The appeal of productivity rating lies primarily in the fact that local assessors are not burdened with the work involved in computing the income attributable to each tract of land. Ratings have been criticized because they fail to take into account many of the factors which affect farm land values, such as location, accessibility, and differential suitability for different kinds of crops.⁹²

In summary, the magnitude of the tax benefits which a particular program provides will be significantly influenced by the method of assessment used. If the comparable sales technique is used, as is possible in some states, development value will be included in fair market value. If this is done, the differentially assessed value will be raised and consequently the tax benefit conferred will be reduced. If productivity ratings are used, they may understate agricultural use value. In addition, where such ratings are used across an entire state, they will not take into account locational differences, such as rainfall and accessibility to markets. Thus, they will underestimate agricultural use value in some areas, and overestimate it in others. Where the capitalization of income method is used, generous estimates of income will result in higher agricultural use value; while conservative estimates will lower it. Capitalization rates will also have a significant influence on the magnitude of tax benefits. We have seen that capitaliza-

90. See, e.g., Ferraro, *Valuation of Property Interests for Ad Valorem Taxation of Extractive Industry and Agricultural Realty*, in *THE PROPERTY TAX AND ITS ADMINISTRATION* 134 (A. Lynn, ed. 1969).

91. STATE BD. OF TAX COMM'RS, INDIANA REAL PROPERTY APPRAISAL MANUAL at F-5 (1968); MARYLAND DEP'T OF ASSESSMENT AND TAXATION, GUIDE TO VALUATING AND ASSESSING LANDS DEVOTED TO FARM AND AGRICULTURAL USE *reprinted in* UNTAXING OPEN SPACE, note 8 *supra*, at 134.

92. U.S. DEP'T OF AGRICULTURE, DIFFERENTIAL ASSESSMENT OF FARMLAND NEAR CITIES 28-29 (1967).

tion rates vary from as low as 5% in Maryland to as high as 10% in New Jersey.⁹³ A New Jersey farm which is identical in all other relevant respects to a Maryland farm would be appraised at approximately half the appraised value of the Maryland farm and receive correspondingly greater tax benefits.

2. Deferred Taxation

Thirty states (including three restrictive agreement states), with a total of thirty-five different differential assessment programs, have included provisions designed to recapture some or all of the taxes which farmers and other owners of undeveloped land were excused from paying pursuant to the programs.⁹⁴ These convert what, under pure preferential assessment is a tax abatement program, into a full or partial tax deferral program. Tax deferral creates an overhanging contingent liability for back taxes in the statutorily mandated amount which becomes a legal obligation when the land is converted to non-eligible uses, or, in some states, such as Oregon,⁹⁵ when the owner initiates a rezoning to residential, commercial or industrial uses. Some states, such as Washington,⁹⁶ impose an additional penalty in the form

93. See notes 85-88 and accompanying text *supra*.

94. ALASKA STAT. § 29.53.035 (Michie 1976); CAL. GOV'T CODE §§ 51200-51205, CAL. REV. & TAX. CODE §§ 421-429 (Deering Supp. 1977); COLO. REV. STAT. §§ 137-1-3(5) to -3(6) (Michie 1973); CONN. GEN. STAT. §§ 7-13(a) to -131n, 12-107a to -107f, -504a to -507h (1977); HAW. REV. STAT. §§ 246-12, -12.3 to .4 (Dedication Program), -10 (Deferral Program) (Supp. 1975); ILL. CONST. art. 9, § 4(b); ILL. ANN. STAT. ch. 120, §§ 501(a)(1)-501(1)(3) (Smith-Hurd Supp. 1977); KY. REV. STAT. ANN. §§ 132.010, 190-.200 (Baldwin 1976); LA. REV. STAT. ANN. §§ 47.2301-.2309 (West Supp. 1977); ME. REV. STAT. tit. 36, §§ 1101-1118 (West Supp. 1977); MD. ANN. CODE art. 81, § 19(b) (Michie Supp. 1976); MASS. ANN. LAWS: ch. 61A, §§ 1-24 (Michie/Law Co-op. 1977); MICH. COMP. LAWS §§ 554.701-.719 (MICH. STAT. ANN. §§ 26.1287(1)-1287(19) (Callaghan Supp. 1976)); MINN. STAT. ANN. § 273.111 (West Supp. 1976); MONT. REV. CODES ANN. §§ 84-401, -429.12, -437.1 to .17 (Smith 1974 & Supp. 1976); NEB. REV. STAT. §§ 77-1343 to -1346 (Supp. 1974); NEV. REV. STAT. §§ 361.325, 361A.010-.160 (Assessment of Agricultural Property), .170-.250 (Assessment of Open-Space Property) (1975); N.H. REV. STAT. ANN. §§ 79A:1-.14 (Supp. 1975); N.J. STAT. ANN. §§ 54:4-23.1 to .23 (West Supp. 1977); N.Y. AGRIC. & MKTS. LAW §§ 300-307 (McKinney Supp. 1976); N.C. GEN. STAT. §§ 105-277.2 to .7 (Michie Supp. 1975); OHIO REV. CODE ANN. §§ 5713.30-.39 (Page Supp. 1976); OKLA. CONST. art. X, § 8; OR. REV. STAT. §§ 308.345-.403, 215.203-.263 (1975); PA. STAT. ANN. tit. 16, §§ 11941-11947; tit. 72, §§ 5490.1-.13 (Purdon Supp. 1977); R.I. GEN. LAWS §§ 44-27-1 to -6, -5 to -12, -39 to -41 (1970); S.C. CODE §§ 65-1605.1 to .2 (Michie Supp. 1975) *as amended by Act 750, 1976 S.C. Acts*; TENN. CODE ANN. §§ 67-650 to -658 (Bobbs-Merrill 1976); TEX. CONST. art. VIII, § 1-d; UTAH CODE ANN. §§ 59-5-87 to -105 (Smith Supp. 1977); VT. STAT. ANN. tit. 24, § 2741 (Development Rights Program) (Equity Supp. 1977); VA. CODE §§ 58-769.4 to .15:1 (Michie Supp. 1977); WASH. REV. CODE § 84.34.010 (Bancroft-Whitney/West Supp. 1976).

95. OR. REV. STAT. § 308.397 (1975).

96. WASH. REV. CODE § 84.34.010 (Bancroft-Whitney/West Supp. 1976).

of a percentage of the taxes due, if the owner converts prematurely or without giving appropriate notice. A few states, such as Connecticut⁹⁷ and New Hampshire,⁹⁸ impose a conveyance tax at the time of sale which has a similar economic effect but is calculated without reference to taxes foregone. Massachusetts has both a deferred tax and a conveyance tax.⁹⁹

The methods of computing these deferred, or rollback taxes vary considerably. The smallest rollback is two years back taxes on untaxed development value without interest,¹⁰⁰ while the largest is in Hawaii which under its dedication program, requires ten or twenty years rollback, depending on which term of dedication is chosen.¹⁰¹ Since in most cases the average effective property tax rate on farmland in the urban fringe is in the 1.2% to 2.75% range,¹⁰² a five year rollback of taxes would amount to at most 14% of the development value of the land (or the difference between fair market value and the current use value determined by assessors).

It can be stated that as a general rule, deferred taxes will constitute between 2% and 15% of the fair market value of the land at the time of conversion depending on effective tax rates, rollback term, market value and current use value. Since these payments are, in most cases, classified as taxes rather than penalties, they are deductible for federal income tax purposes¹⁰³ and also are not treated as capital expenses, which would require them to be treated only as reductions to cost basis for capital gains purposes.¹⁰⁴ A few states have enacted provisions imposing a conveyance tax on land which has been enrolled in a differential assessment program and then converted to a non-eligible use.¹⁰⁵

97. CONN. GEN. STAT. § 12-504a (1977).

98. N.H. REV. STAT. ANN. § 79A:7 (Supp. 1975).

99. MASS. ANN. LAWS ch. 61A, §§ 7, 12 (Michie/Law. Co-op. Supp. 1977).

100. N.J. STAT. ANN. § 54:4-23.8 (West Supp. 1977).

101. HAW. REV. STAT. § 246-10(f)(3) (Supp. 1975).

102. See note 10 *supra*.

103. I.R.C. § 164(a)(1).

104. *Id.*

105. New Hampshire, for instance, requires payment of a tax equal to 10% of the assessed value at the time of conversion. N.H. REV. STAT. ANN. § 79A:7 (Supp. 1975). Connecticut has a declining conveyance tax on lands withdrawn from the program within the first ten years of classification or ownership, whichever is earlier. The tax liability starts at 10% of sale price in the first year of ownership and declines 1% annually to 1% in the tenth year, and none thereafter. CONN. GEN. STAT. § 12.504a (1977).

These deferred taxation and conveyance tax provisions have two principal objectives. First, they are designed to capture some of the tax revenues lost because of the differential assessment program. Second, they are designed to deter owners of land which have received tax benefits from converting their land. Whether or not it has such an effect will be considered more fully in the next section.

Suffice it to say here, that the inclusion of deferred tax liability or conveyance taxes conflicts with the goal of providing tax benefits to farmers. First, it will deter some farmers from entering the program because the mere deferral of taxes may not be a sufficient inducement to enroll, especially if the owner will have to pay interest on these amounts at rates as high as 10%, as in Washington.¹⁰⁶ This will be especially true when there is currently *de facto* preferential taxation. Second, farmers who do enroll and later develop their land will obviously derive lower tax benefits from the program than they would from pure preferential assessment, although for the long-term farmer, the difference may not be important.

3. Restrictive Agreements

Of the five programs¹⁰⁷ which have been classified as bona fide restrictive agreement programs, only California's has been used extensively and long enough to warrant analysis.¹⁰⁸

Under California's Williamson Act,¹⁰⁹ an owner of eligible land may enter into a contract with the county or city in which the land is located, under which he agrees to maintain the land in eligible uses.

106. WASH. REV. CODE § 84.34.010 (Bancroft-Whitney/West Supp. 1976).

107. CAL. GOV'T CODE § 51200-51205, CAL. REV. & TAX. CODE §§ 421-429 (Deering Supp. 1977); FLA. STAT. ANN. § 193.501 (West Supp. 1977); MICH. COMP. LAWS §§ 554.701-.719 (MICH. STAT. ANN. §§ 26.1287(1)-.1287(19) (Callaghan Supp. 1976); N.H. REV. STAT. ANN. §§ 79A:15-.21 (Supp. 1975); VT. STAT. ANN. tit. 24, § 2741 (Equity Supp. 1977).

108. California's Williamson Act was passed in 1965, and since has been used extensively. CAL. GOV'T CODE §§ 51200-51205 (Deering Supp. 1977). In 1975, some 14,250,000 acres (approximately 30% of the privately owned land in the state) had been enrolled under it. UNTAXING OPEN SPACE, *supra* note 8, at 271. Florida's statute relates only to recreational and park land. Michigan's statute, enacted in 1974, is too new. New Hampshire's statute is also new, having been enacted in 1973, and relates only to open space land, and Vermont's statute, while it covers farmland, is a special case in that it authorizes land owners to contract with town governments to set assessed values and tax rates for a period not to exceed ten years.

109. CAL. GOV'T CODE §§ 51200-51205 (Deering Supp. 1977). See UNTAXING OPEN SPACE, *supra* note 8, at 271-302; Hansen & Schwartz, *Prime Land Conservation: The California Land Conservation Act*, 31 J. OF LAND AND WATER CONSERVATION 198 (1976).

The contract is for a period of ten years and is automatically renewed each year for an additional year. If the owner gives notice of non-renewal, he becomes liable for taxes according to a complex statutory formula. In the first year after non-renewal, taxes generally are approximately 60% what they would be if the land were assessed on the basis of fair market value. Each year for the rest of the run-out period they increase gradually until, at the end of ten years, they are at market value rates. The owner may also attempt to cancel the contract, but to do this he must obtain the approval of the city or county and pay a cancellation fee equal to 12.5% of the fair market value of the land. It is possible to have the cancellation fee waived, but to do this, he must secure the approval of the secretary of the state resources agency.

The essential feature of the restrictive agreement approach which distinguishes it from other types of differential assessment programs is that the owner is reasonably certain that he will not be able to develop his land until the end of the run-out period. A farmer contemplating enrolling in this type of restrictive agreement program will be faced with the question of whether he wants to tie up his land for at least ten years and pay taxes during the run-out period totaling at least 50% of what he would otherwise pay. The clear evidence in California is that only those owners who are certain that they will not convert their land within ten or fifteen years have signed up under the Williamson Act.¹¹⁰

Thus, the restrictive agreement approach is clearly inconsistent with the general goal of providing tax benefits to farmers. Those farmers who are most in need of tax relief, because their land is located in urbanizing areas with rising fair market values and tax rates, will be precisely the ones least likely, for economic reasons, to tie up their land for a number of years. Those who are in rural areas with the least development pressure will be the ones who enroll. The intended major beneficiaries of a differential assessment program, farmers in the rural-urban fringe, would not receive its benefits.

In summary, differential assessment is a generally effective means for conferring tax benefits on participating landowners. The amount of the taxes saved by individual farmers will vary substantially, however, depending on a number of factors. The greater the development value (exclusive of farm use value) of the land, the greater the reduction in assessment. In suburbanizing areas, a reduction of over 90% is possi-

110. UNTAXING OPEN SPACE, *supra* note 8, at 293; Hansen, & Schwartz, *Prime Land Conservation: The California Land Conservation Act*, 31 J. OF LAND AND WATER CONSERVATION 198, 202 (1976).

ble; in areas with little development pressure the reduction may be minimal. In order, however, to make up for the reduced total assessment in the taxing district, the general tax rate must be increased. This increase will be small if there is a large amount of non-participating property to share the burden of the loss in assessment. Therefore, the smaller the proportion of the total tax base (before differential assessment) accounted for by land in the program, the larger the savings to a participating land owner. The few remaining farms in a generally built-up township will thus receive the highest tax savings. Similarly, if the tax base was made up of predominantly participating land, tax savings would be small.

If, however, the assessed value of an individual participating property includes a large proportion of non-eligible buildings and land, tax savings for that owner will be generally small. Also, if *de facto* differential assessment existed before the program, assessment itself might change little because of the program, and could even increase.

The various types of differential assessment programs can be arranged in a very rough spectrum with respect to their effectiveness in making tax benefits available and attractive to land owners. Pure preferential assessment programs with few eligibility conditions and methods of assessment which produce a low assessed value based on current, agricultural use value, are most effective. They are easy for owners to enter and award full abatement of taxes on the development value of land. As eligibility criteria are multiplied and tightened, fewer will enroll and thereby receive tax benefits.

Deferred or rollback tax payments reduce the economic attractiveness of the program for some farmers and thus deter some from enrolling their land. The longer the rollback and the higher the interest rate, the less incentive there is for the farmer to enter his land in the program.

The restrictive agreement approach is least effective for achieving the goal of awarding tax benefits to owners of eligible land because the prospect of being locked in, unable to develop their land but paying near market-value property taxes, will deter many owners from putting their land under contract. Only those who are living in essentially rural areas or are wholly committed to agricultural activity, and who do not expect to develop their land within the period of the contract, will be likely to be compensated for the costs resulting from the forced postponement of conversion.

III. EFFECTIVENESS: ACHIEVING LAND USE OBJECTIVES

A major objective of differential assessment legislation in many states has been to keep farm and other rural land in its current use, or at least to reduce its rate of conversion to urban uses.¹¹¹ Planners and conservationists have argued that a significant percentage of sales of farmland for development occurred because of the profit squeeze felt by the farmers, especially in rural-urban fringe areas. They reasoned that a program which would lower or put a ceiling on one of the farmer's major cost components, the real property tax, would lessen the squeeze and therefore reduce the number of forced sales. The validity of this line of reasoning, and the effectiveness of differential assessment legislation with respect to its primary goals of maintaining current, open use will be explored in this section.

The effectiveness of differential assessment laws for maintaining current use of undeveloped land depends on how many farmers who are considering conversion will enroll, and on how large an economic incentive they will receive if they refrain from converting.

Differential assessment can influence the rate of conversion of farm and other open land in two principal ways. First, a farmer's total production cost may be lessened, and his land made more profitable, by a substantial reduction in his property taxes. This effect, which is often viewed as an attempt to lessen the income squeeze which farmers in the rural-urban fringe experience, has been the principal focus of legislators when they speak of preventing forced conversions. The reduction in taxes may be especially significant in metropolitan areas or areas with a large potential for second home development, since in such places the differences between current use value and fair market value may be large. In these areas, fair market value may be as much as fifteen or twenty times current use value.¹¹² Where there is no *de facto* differential assessment, a differential assessment program in such cases could reduce a landowner's property taxes by as much as

111. See, e.g., CONN. GEN. STAT. §§ 12-107a to -107f (1977); FLA. STAT. ANN. § 193.461 (West Supp. 1977); N.M. STAT. ANN. § 72-29-9 (Smith Supp. 1977); OR. REV. STAT. §§ 308.345-403 (1975); PA. STAT. ANN. tit. 72, § 5490.1-13 (Purdon Supp. 1977). See also Atkinson, *The Effectiveness of Differential Assessment of Agricultural and Open Space Land*, 36 AM. J. OF ECON. AND SOC. 197 (1977); Lapping, Bevins & Herbers, *Differential Assessment and Other Techniques to Preserve Missouri's Farmlands*, 42 MO. L. REV. 369 (1977); Nelson, *Differential Assessment of Agricultural Land in Kansas: A Discussion and Proposal*, 25 KAN. L. REV. 215 (1977); Roe, *Innovative Techniques to Preserve Rural Land Resources*, 5 ENVIRONMENTAL AFFAIRS 419 (1976).

112. Interview with William Riley, Director, Maryland Dept. of Taxation (Feb. 11, 1975).

90%. Because property taxes consume an average of 10.4% of farmers' net income,¹¹³ it is reasonable to suppose that tax reductions, or at least deferrals, of this magnitude will enable some farmers to continue farming over the short term.

The second way in which differential assessment could serve the goal of maintaining current use is by making it possible for people wishing to buy land for farming to reduce their potential carrying cost sufficiently (by reducing taxes) so that they could pay more for the land and out-bid potential developers. Unless farmers can pay nearly as much as developers, the question is when, and not whether, property will be converted to more profitable uses.

A. *Supply and Demand and the Decision to Sell*

Differential assessment changes the carrying costs of farmers' land. Whether such changes result in decreasing the rate at which land is converted to urban uses is another question. In order to answer it, it is necessary to examine the decision-making process which a farmer goes through when faced with a chance to sell his farm. Special emphasis will be given to the role real property taxes play in that process. Further, the issue of whether tax reductions can function as an incentive not to sell will also be examined.

Decisions to sell and convert are affected by both supply and demand considerations. The supply of farmland for conversion purposes is affected by the price offered for land, the farmer's costs of production including property taxes, his cash receipts, a number of demographic and personal factors, and possible externalities generated by other nearby activities. In addition, government programs and policies may indirectly contribute to a farmer's decision to sell. Estate and inheritance taxes may, for example, induce sale and conversion in some instances.¹¹⁴

The demand for farmland for conversion arises because individuals or groups desire to convert the land to such nonagricultural uses as suburban homes or businesses, second homes, strip mines or even timber production. The relative strength of the demand for farmland and the economic, demographic, personal and other factors affecting the supply of farmland for conversion will determine how much agricultural land disappears in any locality.

113. ECONOMIC RESEARCH SERVICE, U.S. DEP'T OF AGRICULTURE, REVISED ESTIMATES OF TAXES LEVIED ON FARM REAL PROPERTY, 1960-73, BULL. NO. 538 (1975).

114. Larocca & Maidenburg, *The Effect of Federal Tax Policy on Land Conversion: A Case Study of Baltimore County 1-3* (The Urban Institute 1974).

It is important to keep in mind that reduction of agricultural property taxes is aimed primarily at one part of the supply of agricultural land for conversion, but that the effectiveness of such a reduction depends upon many other supply and demand conversion factors as well.

1. Supply Factors and the Farmer's Decision to Sell¹¹⁵

Interviews with farmers and county agents and previous research have identified four major classes of factors in the farmer's decision to sell. These four factors are "economic,"¹¹⁶ "demographic,"¹¹⁷ "secondary or indirect" (such as externalities from nearby nonfarm activities) and "transitional"¹¹⁸ (such as a desire for change in either type of work or place of work).

In general, each of the four major classes of factors influencing the decision to sell is a function of the market price of the land—the higher the price, the more likely the farmer is to sell.

Within the universe of general factors affecting the farmer's decision to sell, property taxes are only one component of the economic factors. If a reduction of agricultural property taxes is to cause fewer farmers to sell out, it will do so by shifting some farmers from insufficient net returns to sufficient net returns. Whether this shift can occur

115. UNTAXING OPEN SPACE, *supra* note 8, at 49-56.

116. Economic factors are of central importance in a farmer's decision to sell. They fall into two general groups: first, the price offered for the land may be so high that it is most difficult not to sell, and second, the net returns to the agricultural operation of the farm may be insufficient over the long run to warrant continued farming. Low net returns may be due to low prices for farm output, low yields of crops or livestock products, high costs of labor, and burdensome property and other taxes.

117. The demographic factor is concerned with the farmer's life cycle and the desires of his children, if any exist, to take over the farm. As a farmer nears the age of retirement, he is likely to consider selling his farm to a family member or, if none is willing to continue farming, to a neighbor who, by enlarging his farm, can operate more profitably. But if no such buyer exists, the farmer may put the farm up for sale in the impersonal land market. Should the farmer die before the land is transferred, his estate may be forced to sell it in order to pay estate taxes. Whether or not the land then remains in agriculture depends on the demand for alternative uses.

118. Transitional and secondary factors are the remaining two classes of factors influencing the supply of farmland for conversion. The transitional factor includes change of residence, whether to a farm elsewhere or to a non-farm location, and change of occupation. Under the term, "secondary factors," are lumped the externalities generated by nearby nonagricultural activities which cause the farmer to sell. Among these are: 1) local ordinances placing restrictions on spreading fertilizer, use of pesticides, and on other farm activities which are objectionable to new residents in the area; 2) acid mine drainage or subsidence caused by nearby subsurface or strip-mining activities; 3) air pollution from nearby industrial processors which damages crops; and 4) increased traffic on farm roads, and inadvertent or wilful damage to crops by nearby urbanites.

also depends on long run trends of the other costs of production and on the prices of agricultural output. It should be apparent that, except for interdependencies among the reasons for selling, reduction of the agricultural property tax will have little or no impact on the demographic, transitional and secondary factors in the decision to sell.

2. Research on Supply Factors

The influence of the property tax on the farmer's decision to sell has, rather surprisingly, received only infrequent empirical attention even though forty-four states have differential assessment laws of one type or another.¹¹⁹ Unfortunately, from the limited number of studies available, it is not possible to draw any strong general conclusions about the effect of property taxes on the sale, conversion, or abandonment of farmland, since these studies present only a partially complete picture of the noneconomic factors on the supply side and of variation in the pressures for conversion on the demand side. Several studies, however, are particularly noteworthy.

In a study of forty farmland sales in three New Jersey townships from 1966 to 1970, the following reasons for selling were given:¹²⁰

<i>Economic Considerations</i>	<i>% of All Reasons Given</i>
Taxes were too high	28.6%
Land can no longer be rented at a profit	4.1%
The price was right	18.4%
<i>Demographic Considerations</i>	
Retirement	22.4%
<i>Transitional Considerations</i>	
Desire to move to another area	6.1%
<i>Miscellaneous Considerations</i>	
Decrease the size of current farm operation	10.2%
Other	10.2%

Retirement, taxes, and price offered appear to have dominated the respondents' thinking. It is of interest to note that of the fourteen sellers mentioning higher taxes as a reason for sale, nine were from urbanizing areas, five from urbanized areas, and none from rural areas.¹²¹

119. See note 5 *supra*.

120. G. NAGEL & D. DERR, A PRELIMINARY ANALYSIS OF THE DATA ON PARTICIPANTS IN THE NEW JERSEY FARM REAL ESTATE MARKET, 1966-1970 (New Jersey Agricultural Experiment Station, Rutgers University 1972).

121. *Id.* Respondents to the survey could give more than one reason for deciding to sell and several did so.

Data from a study of land sales in Baltimore County, Maryland,¹²² underscore the importance of life cycle considerations in the decision to sell. Death or retirement accounted for 42% of all sales, title change within family for 11% and moving to another area for an additional 13%.¹²³ Economic considerations (including good price, unavailability of farm labor, and unproductive farmland) totaled 31%.¹²⁴ Land which was subsequently developed for residential use was especially likely to have been made available through life cycle reasons. Eighty-five percent of such land was sold because of death or retirement.¹²⁵ This study also points out that use-value assessment laws enable farmland owners to avail themselves of the private timing incentives that are built into the federal estate and capital gains tax structure, thus reinforcing the importance of life cycle considerations in the decision to sell.

Studies which have investigated specifically the influence of differential tax laws on farmers decisions to sell have reached similar results. When asked directly about the effect of the New Jersey Farmland Assessment Act on their decisions, 56% of the buyers and 59% of the sellers questioned in the New Jersey study cited above said it had no influence.¹²⁶ In another New Jersey study, 60% of participants questioned stated that the Farmland Assessment Act would not influence their decision to sell, while 40% stated that the Act had been a positive force in enabling them to continue to farm.¹²⁷ A 1973 questionnaire survey of several hundred applicants for Washington's open space taxation program produced similar findings.¹²⁸ One conclusion from this study was that most "applicants do not feel that participation in the program and the associated penalties would have any effect upon their deciding to sell the land or change the land use."¹²⁹ When asked if they would have to change land use within the

122. G. Peterson, *Tax Policy and Land Conversion at the Urban Fringe* (Land Use Center Working Paper 0875-04, The Urban Institute 1974).

123. *Id.*

124. *Id.*

125. *Id.*

126. *See* note 120 and accompanying text *supra*.

127. A. Koch, H. Monill, & A. Hausamann, *Implementation and Early Effects of the New Jersey Farmland Assessment Act* (Rutgers Experiment Station Bull. No. 830, Rutgers University 1967).

128. J. Banon & J. Thompson, *Impacts of Open Space Taxation in Washington*, (Washington Agricultural Experiment Station Bull. No. 772, Washington State University College of Agriculture 1973).

129. *Id.*

next five years if denied current use assessment, only 14% of the respondents said "yes." The majority said "no."¹³⁰ The authors caution, however, that few participants understood the penalties for withdrawal from the program or the rollback penalties.

3. The Effect of Differential Assessment on the Agricultural Use Value of Land

The general conclusion that differential assessment, by itself, is likely to be an ineffective deterrent to conversion of farmland is shared by other analysts.¹³¹

The central finding which emerges is that, while the cost of a differential assessment program in a state is measured in terms of tax expenditures to the great number of participating owners, the effectiveness with respect to maintaining current use is measured only in terms of the small number of farmers who are contemplating sale in a given year and who are potentially susceptible to being influenced in their decision to sell by a reduction of their property taxes. Even these will be induced only to postpone sale until a time which fits more appropriately into their own life plans.

If preservation of agricultural activities is a legitimate social goal, intervention in both supply and demand processes must be undertaken. Differential assessment addresses only a small part of the supply process. To be more effective, a comprehensive program should be designed to ameliorate economic and secondary disincentives to farming on the supply side and to channel urban expansion to nonagricultural land on the rural-urban fringe on the demand side.

130. *Id.*

131. J. KOLESAR & J. SCHOLL, *SAVING FARMLAND* (1975); P. House, *Farmland and Farmland Owners on the Edge of a Growing City, with Special Emphasis on Tax Problems—A Case Study of Rochester, New York* (1968) (unpublished Ph.D. dissertation, Cornell University); K. Wisner, *Effects of Agricultural Use-Value Assessments in Washington County, Maryland* (1971) (unpublished M.S. Thesis, University of Maryland); *see also* J. Kolesar & J. Scholl, *Misplaced Hopes, Misspent Millions: A Report on Farmland Assessment in New Jersey* (Center for Analysis of Public Issues 1972).

It is noteworthy that, after remaining fairly constant at about \$1 per \$100 of the market value of farmland from 1955 to 1973, average farm real estate taxes per \$100 of fair market value for the nation dropped to 0.80 per \$100 of fair market value in 1976. *See* 1976 Handbook of Agricultural Charts 22, 22-23 (U.S. Dep't of Agriculture). Whether this is the beginning of a long-term trend toward lower effective tax rates on agricultural land, and whether such a trend could be attributed to the widespread implementation of differential assessments laws, are presently matters of conjecture.

B. *An Evaluation of Alternative Types of Differential Assessment With Respect to Maintaining Current Use*

1. Preferential Assessment

Sufficient data are not available from states, such as Indiana, with pure preferential assessment to make possible a direct empirical analysis of the extent to which pure preferential taxation programs have been effective in slowing the loss of farm and other eligible land to urban development. Based on the analysis of the preceding section, however, it is safe to conclude the following.

If an owner wants to keep his land in open uses, but finds this is financially difficult, the savings from preferential assessment may prove critical in enabling him to attain his desire. If the owner, however, is indifferent, or actively looking for an opportunity to sell to a developer, the tax savings from preferential assessment will not have much effect in deterring him from selling.

If the owner has made his living by farming the land, he may wish to sell when he grows older so that he will be able to retire. Future tax savings then will be of little consideration to him. Also when the owner dies, and does not have an heir who wants to continue the property in its current use, such land will likely be sold on the market to the highest bidder.

Whenever land is sold on the open market, the type of buyer will be determined primarily by the potential of the land for development and its suitability for agricultural production (and in some instances, its potential for strip or other mining). Urban uses nearly always can outbid agricultural uses, no matter how efficient and productive. Tax savings will not be enough to make a difference.

Therefore, preferential assessment is likely to make a difference in the rate of conversion to urban use primarily for land that is in the hands of relatively young owners who are either:

- 1) farmers who want to continue to farm, and are in a location where farming is not impeded by urban neighbors, or
- 2) people who want to maintain a country home.

For these people, the tax saving may be large enough to play a significant role in their decision not to sell.

Preferential assessment has its principal effect on the supply of land which is put on the market in that it reduces the carrying cost of land. It has no effect on the major factor which determines demand: accessibility to growing urban centers. It does, however, affect demand in

that a potential buyer can bid more in the realization that for as long as he keeps the land in approved open space uses, he too, will enjoy lower carrying costs. In most cases, this additional amount will not be enough to enable the farmer to outbid the developer. In addition, if the developer can take advantage of the preferential assessment law, as he can do in several states,¹³² the farmer's advantage will be nullified. The result will be that the price of land is bid up and perhaps more land will be purchased by potential developers taking advantage of lower carrying costs.

Pure preferential assessment, because it invokes no sanctions against participants who leave the program, should attract the maximum number of participants. However, the mere fact that more participate probably will have little effect on the rate of conversion to other uses. Only those owners who have a strong incentive, in addition to the tax savings, to maintain their land in its current use are likely to use the tax saving to maintain that use. Most of these owners would probably participate even in a program with strong sanctions. The others will enjoy the financial advantages of the tax reduction and then sell when it is economically advantageous.

Thus, except for certain circumstances, preferential assessment is not very effective in maintaining current use in urban fringe areas even in the short run. In the long run, where death and retirement and the demand for land for other uses play the major roles in the decision process, it is of very little significance indeed.

2. Deferred Taxation

Provisions for deferred taxation, in addition to pure preferential assessment, provide some deterrent to changing use. The purpose of this section is to evaluate how great a deterrent deferred taxation can be expected to be.

Deferred taxation or conveyance tax requirements are found in the thirty-five differential taxation programs of thirty states.¹³³ The rollback requirements in fifteen programs simply require the payment of the difference between taxes under preferential assessment and what taxes would have been under market assessment for the number of years stated in the rollback provision.¹³⁴ In the remaining thirteen

132. See, e.g., IND. CODE ANN. § 6-1.1-4-13 (Burns Supp 1976); N.J. STAT. ANN. §§ 54:4-23.1 to -23.6 (West Supp. 1977).

133. See notes 21 & 94 *supra*.

134. *Id.*

programs, interest is also charged on the back taxes.¹³⁵ In addition, several states have a conveyance tax which is determined by market value at time of sale.¹³⁶

The rollback period is typically about five years, but is as short as two years in a number of states¹³⁷ and as long as fifteen years for certain types of land in Maine.¹³⁸ Stipulated interest rates are typically 6%,¹³⁹ but are as high as 10% in Hawaii.¹⁴⁰

a. Rollback Without Interest

The penalty imposed by rollback without interest charge is minor. In fact, it simply allows an owner to postpone paying certain taxes (in excess of those based on agricultural value) until his land is developed. This is equivalent to an interest-free loan to the owner.

Even the total amount of the rollback is not large in proportion to market value. Tax rates are generally in the range of 1% to 3% of market value, and the rollback taxes are computed only on the difference between farm value and market value. Therefore, even Oregon's ten-year rollback would amount to no more than 30% of the difference between assessed and market value.¹⁴¹

b. Rollback With Interest Charge

The requirement of an interest charge could create a true penalty, but only to the extent that the interest rate charged is higher than that which a land owner would have to pay were he to borrow from a commercial lending institution. The interest rate provisions in force have not constituted a true penalty for conversion over the past several years in any state,¹⁴² except possibly Hawaii with its stipulated 10% charge.¹⁴³ The tax rollback and interest charge, however, can consti-

135. *Id.*

136. *See, e.g.,* ME. REV. STAT. ANN. tit. 36, § 1112 (West Supp. 1977).

137. *E.g.,* R.I. GEN. LAWS § 44-5-39 (Supp. 1976).

138. ME. REV. STAT. ANN. tit. 36, § 1112 (West Supp. 1977).

139. *See* UNTAXING OPEN SPACE, *supra* note 8, at 69.

140. HAW. REV. STAT. § 246-10(f)(3) (Supp. 1975).

141. *See* UNTAXING OPEN SPACE, *supra* note 8, at 214-16.

142. This is so because if the interest rate charged on rollback taxes is equal to or less than what the farmer would have to pay a commercial lending institution, it costs the farmer the same or less than what he would have to pay such a lender to defer his taxes.

143. The 10% rate may be higher than commercial interest rates on loans to farmers.

tute a substantial payment and, therefore, could have some psychological effect on the decision to develop.

Studies by other researchers have also concluded that rollback even with interest cannot offset the increased capital gain which is usually realized when land is converted to urban uses.¹⁴⁴

Another view the owner might take is to compare his rollback costs not to total market value, but to the appreciation in value of his property during the period the rollback covers. He might argue (other things being equal) that it was not advantageous for him to sell at the beginning of the period. He will consider selling or developing therefore, only if the appreciation in value during the period exceeds the total bill he will have to pay for rollback taxes and interest.

Finally, some landowners may be deterred from entering a deferred taxation program even if it might be in their economic interest to do so. For them the prospect of being required to pay a large amount of back taxes, in some states with interest, combined with the time and expense required to enroll their land, more than offsets the advantages of a reduced assessment. A deferred taxation program will not be effective in influencing the decision of a landowner who has refrained from entering into it.

c. Conclusions

Based on the above reasoning and computations, it is probably safe to conclude that rollback requirements, even with substantial interest payments, are not likely to be an effective deterrent to development. This is particularly so in areas where development demand is strong and land values are increasing rapidly.

Although rollback provisions would not seem to add greatly to the effectiveness of preferential assessment in preventing the conversion of land to urban uses, nonetheless, a sanction such as rollback is a necessary provision from the standpoint of equity. Without a rollback provision, preferential assessment laws provide a free ride for the speculator, at the cost of others whose taxes are increased to make up for the loss in revenue. It is only fair that this lost revenue be made up to the public when conversion occurs. In the interest of fairness, interest should be charged at a rate equal to the rate which other taxpayers would have had to pay in order to provide the lost revenues.

144. See R. GLOUDEMANS, *USE-VALUE FARMLAND ASSESSMENT* (1974); D. Holland, *An Economic Analysis of Washington's Differential Taxation Program* (College of Agriculture Research Center, Circular 578, Washington State University Dec. 1974).

3. Restrictive Agreements

Restrictive agreements (under which an owner agrees not to develop his land for, say, ten years, knowing that the agreement will be enforced by a state or local agency) have considerable potential as a means of maintaining current use, at least over the term of the contract. They have not been particularly effective in maintaining current use in California primarily because they are voluntary, and an owner of eligible land may choose not to enroll his land.¹⁴⁵ As is reported in a recent study of California's Williamson Act,¹⁴⁶ while some 46% of privately-owned eligible agricultural land in the state was under contract in 1976, almost all of it was rural land not subject to near-term development pressure.¹⁴⁷

The consensus of the literature is that only owners who are committed to agriculture and have no expectations of developing their land within the next ten or fifteen years will put their land under contract.¹⁴⁸ Those whose land is ripe for development, or who expect that it will be within ten years, have, by and large, declined to enter the California program.

One aspect of California's program may have a noticeable effect on conversion rates. The program creates agricultural preserves within which contracts may be written.¹⁴⁹ Participants have standing to protest cancellation. By creating a legal structure aimed at preserving agricultural use and vesting owners with an interest in maintaining the integrity of the district, the system operates to retard change. This effect may be more significant as a means of preserving current agricultural use than the simple economic incentive of preferential assessment.

The potential usefulness of restrictive agreements, coupled with differential assessment, lies in their use as a mandatory device which is part of an overall conservation and development policy for metropolitan areas. This approach in transitional areas, together with acquisition of less-than-fee interests in lands designated for open space use and subject to heavy development pressure, on the one hand, and simple

145. See note 110 *supra*.

146. Hansen & Schwartz, *supra* note 109, at 202.

147. Williamson Act Study Group, *The Property Tax and Preservation of Open Space Land in California: A Study of the Williamson Act 80* (Stanford Environmental Law Society 1974).

148. Land Research Group, *Measures for Strengthening the California Land Conservation Act 55* (Division of Environmental Studies, University of California-Davis 1974).

149. CAL. GOV'T CODE § 51230 (Deering Supp. 1977).

police power regulation of land not subject to heavy pressure, on the other, would provide a flexibility which is much needed. The usefulness of the restrictive agreement alone for maintenance of current use is effectively limited by its voluntary nature.

C. *Conclusions Concerning the Achievement of Land Use Objectives*

Except for a few specific situations, which account for a small fraction of potential sales of farmland, differential assessment is not likely to be effective in achieving land use objectives. Whether or not a particular farm is sold and converted to non-open space use depends on three sets of considerations: supply factors, demand factors and governmental approval of the proposed development. Differential assessment operates primarily on one of the supply factors, by reducing the income squeeze which farmers in rural-urban fringe areas experience as a result of rising real property taxes. It has a secondary impact on the demand side because it permits farmer-buyers, speculators and developers either to offer somewhat more for the land or to buy more land at the same price because their carrying costs are reduced. This latter effect is difficult to appraise, but is likely to be marginal because the buyer will normally be simply exchanging tax costs on the land for interest costs on the money he has to borrow either to pay the higher price or to buy additional land.

It is clear, however, that all forms of differential assessment help to insulate the farmer from market pressures to sell which come to bear on him in the form of higher property taxes based on rising property values. They make it easier for him to schedule the sale of his land at a time, such as retirement, which fits into his estate planning.

One of the central issues raised by differential assessment with respect to the goal of maintaining current use is which of the systems for timing the sale and conversion of land is best:

1. a system which keys the conversion of open land into personal life cycle and estate planning considerations of individual farmers;
2. a system which relies on the push of rising property taxes and the pull of high offers to ease land into development; or
3. a system which relies more heavily on governmental resource and development planning to specify which land should be developed when.

Studies have documented the additional economic, environmental and energy costs which are associated with low density, leap-frogging

development,¹⁵⁰ precisely the kind which Peterson found in his study of differential assessment in Maryland.¹⁵¹ In light of these findings, it seems clear that differential assessment programs which are not part of a comprehensive land development regulation system are counter-productive in terms of the broader goals of urban development.

The benefits which they provide for individual farmers by way of short-term postponement of some conversions are more than counterbalanced by the disadvantages they entail in creating special tax shelters in which owners of developable land may thrive until their personal economic plans coincide with those of the market generally. Such programs should either be amended or made a part of a larger system of resource management and development regulation. Such a system would entail the designation of agricultural and development districts, staging of capital facilities and development, compensation, and differential assessment.

IV. TAX EQUITY, EASE OF ADMINISTRATION AND POLITICAL FEASIBILITY

Tax shifts resulting from differential assessment raise the major issues concerning equity. Whether or not farmers are paying excessive property taxes is initially a political issue and, in any event, a factual question on which the evidence is not clear. It is evident, however, that differential assessment programs work by shifting some of the burden of the real property tax in a particular taxing jurisdiction from farmers and other owners of eligible land to all other taxpayers.

The amount of this shift, or the tax expenditure, ranges from a very small percentage of total tax revenues where a small percent of the fair market value tax base is in eligible farmland, to a peak where about 60% of the tax base is in eligible farmland, and then declines to a small amount where virtually all the tax base is in farmland.¹⁵²

If public services are not to be reduced, these tax expenditures must be compensated for by raising the tax rate. If for example, assessment on participating land is reduced by 50% and participating land made up 50% of the tax base (when assessed at market value) then the tax rate would have to be raised by 33%. Though all taxpayers would face this

150. REAL ESTATE RESEARCH CORP., *THE COSTS OF SPRAWL* (U.S. Government Printing Office 1974).

151. Peterson, *supra* note 122.

152. For a detailed analysis of the tax expenditure aspects of differential assessment and the derivation of the equation for measuring tax shifts, see *UNTAXING OPEN SPACE*, *supra* note 8, at 80-99.

increase, it would be offset by the reduction in assessment for owners of participating land. The full increase of 33% would be faced by non-participating landowners, typically townspeople, businesses and industries.

Analyzing actual data on tax shifting indicates that of thirty-nine Florida counties, over half (twenty-one) experienced a tax rate increase of less than 4% and all but three had an increase of less than 10%.¹⁵³ A study of 151 rural New Jersey townships revealed that over half had tax rate increases of under 20%, while another 40% had increases of 20% to 50%.¹⁵⁴ Analysis of California data showed that of the forty-six counties under the Williamson Act, thirty-eight or 82% experienced revenue losses of less than 3% to 9% and only two of more than 10%.¹⁵⁵

The tax rollback or conveyance tax provisions serve to mitigate the tax shifts discussed above, when farmers start selling participating land for conversion to ineligible uses.

As the real estate market adjusts to the new tax ground rules established by a differential assessment program, values of differentially assessed land will tend to rise (because carrying costs are reduced), and value of other land will tend to fall because taxes attributable to it are somewhat higher. Of course, the rollover and recapture of deferred taxation and the provisions of restrictive agreements can reduce or eliminate this effect. All these effects will counteract to some extent the initial tax shift impact.

In summary, the tax shift in a small rural township could be quite significant, if land is under development pressure. In a large community with a significant non-farm tax base, it will normally be a much smaller percentage. On a statewide basis, in the four states of those studied which had sufficient data, tax shifts constituted less than 3.5% of total tax revenues. While the percentages of shift were relatively small, the amount of tax shifts was significant. In Washington (with a relatively new program) it was \$2.7 million, in Oregon, \$24.9 million, in New Jersey, \$40 million and in California, \$60 million.¹⁵⁶ As landowners enroll in the more recently enacted programs around the country,

153. *Id.* at 90-93.

154. J. KOLESAR & J. SCHOLL, *SAVING FARMLAND* (1975).

155. *UNTAXING OPEN SPACE*, *supra* note 8, at 288-90.

156. *Id.* at 95-98.

legislatures will be confronted with the decision as to whether tax shifts of this magnitude can be justified either on the basis of tax relief for farmers, which they clearly achieve, or on the basis of the preservation of open land which they fail to secure.

Four states have adopted provisions which seek to lessen the tax shift in municipalities. Under California's Williamson Act, the state has made so-called "subvention" payments to participating county and city governments which, according to informed estimates, amounted to about one-third of statewide tax expenditures.¹⁵⁷ New York's law provides for state reimbursement of one-half of the tax losses resulting if the state creates an agricultural district.¹⁵⁸ Michigan softens the tax expenditure burden at the local level by allowing eligible landowners to credit any property taxes in excess of 7% of their income against the state income tax.¹⁵⁹ Alaska has legislative authorization for full state reimbursement of local tax losses.¹⁶⁰

There is a pervasive need for more and better information about the operations of differential assessment. Most states have simply failed to establish data recording, collection and dissemination systems adequate to perform the job. And yet, as differential assessment programs mature, they involve a major re-allocation of tax burden, and those who are paying higher tax bills have a right to accurate information about the magnitude of the tax expenditure and the efficacy of the program for achieving legitimate public objectives.

Preferential assessment programs are the simplest to administer because assessors need only compute current use value and police their jurisdictions to see that enrolled land remains in eligible use. Deferred taxation programs usually require assessors to determine both current use value and fair market value each year so that the deferred taxes may be computed. At the time of conversion, back taxes must be determined and collected. On a per farm basis, restrictive agreement programs require most attention because of the work involved in preparing the contract, and if the program is like Califor-

157. *Id.* at 286-88. There are many factors that make it difficult to estimate tax losses or shifts with confidence. Some of the foregoing revenue may be offset by higher taxes on unrestricted lands whose value has increased because of development pressure deflected from restricted lands or because of proximity to protected open space. See *The Property Tax and Preservation of Open Space Land in California: A Study of the Williamson Act*, *supra* note 147, at 89-96.

158. N.Y. AGRIC. & MKTS. LAW § 305(1)(f) (McKinney Supp. 1976).

159. MICH. COMP. LAWS § 554.711 (MICH. STAT. ANN. § 26.1287(10) (Callaghan Supp. 1976)).

160. ALASKA STAT. § 29.53.035(e) (Michie 1976).

nia's, in determining the taxes due during the run-out period. This additional work will be somewhat compensated for since smaller percentages of landowners will enroll their land than in the other types of programs.

Cost can be reduced by state assistance covering such matters as assessment procedures, data storage and retrieval and calculation of back taxes. Many of the programs examined charge application fees of sufficient magnitude to cover costs of processing, so that most, if not all, of the expenses are passed on to the beneficiaries of the program. Generally, expenses at the state level are minimal.

Differential assessment has a basic political appeal. Once enacted, this method is invisible and is not subject to annual budgetary review, except, of course, in the few states which have some form of subvention.

The recognition that differential assessment alone is ineffective for preserving open space has led legislators in a growing number of states to consider stronger devices such as public purchase of development rights or privately transferable development rights. New Jersey is in the course of implementing an experimental development rights purchase program,¹⁶¹ and in 1977, Maryland adopted a comprehensive program for the preservation of agricultural land which included the acquisition of agricultural easements.¹⁶² Across the country, legislatures are experimenting with a wide variety of techniques for preserving agricultural land, such as exclusive agricultural zoning, purchase and leaseback of agricultural land, inverse condemnation, valuation of farmland for estate and inheritance purposes at farm use value, and agricultural districting.¹⁶³ While not sufficient in and of itself to save valuable farmland, differential assessment will undoubtedly constitute an important component of any general effort to preserve agricultural land.

RECOMMENDATIONS

A. If differential assessment is to be a useful land use device, existing legislation should be amended (and new legislation should be written) so as to contain the following provisions:

1. All differential assessment statutes should provide for deferred

161. See note 3 *supra*.

162. MD. ANN. CODE art. 2, §§ 503-515 (Michie Supp. 1977).

163. See R. COUGHLIN, *SAVING THE GARDEN: THE PRESERVATION OF FARMLAND AND ENVIRONMENTALLY VALUABLE LAND* (1977).

taxation in order to achieve greater equity among all taxpayers. The rollback period should be at least ten years, and preferably, the entire period during which tax savings were enjoyed. Interest should be charged on the deferred tax benefits at rates at least as high as those charged by commercial lending institutions.

2. States which mandate differential assessment by units of local government should provide at least partial compensation for the tax expenditures which result. The reason for this is that the benefits in preserving agriculture and open space which may result from differential assessment are enjoyed far beyond the boundaries of the local taxing jurisdiction in which the differentially assessed land is located. Therefore, the costs should be shared broadly, not borne solely by the non-eligible taxpayers of the local jurisdiction.

This can be done either by a state subvention, as in California,¹⁶⁴ or through the use of a state income tax credit as in Michigan.¹⁶⁵ In any case, uniform assessment procedures should be set up and enforced by the state so that each jurisdiction is treated equally.

3. A statewide data system should be established and made part of the basic legislation. The information collected should allow officials to assess the expenditures involved in the differential assessment programs and to determine more accurately the impact of the program on rates of sale and conversion. This information would also be useful for general planning purposes.

B. By itself, differential assessment is an inadequate tool for achieving the goal of maintaining current use. It is, however, a useful component of a broader approach which should have the following characteristics:

1. Eligible land should be designated specifically following studies of its capability for agriculture, the need for farmland and land in other open uses, and the projected demand for land for urban development, vacation houses, strip mining, and other non-agricultural uses. It is especially important that the agricultural districts designated be large enough to be functionally and economically viable and located so that they will be relatively free from intrusion of urban and suburban activity. The designation of these areas will determine large-scale land use patterns. Therefore, designation should be made by state, regional, or possibly county government, rather than by local government.

164. CAL. GOV'T CODE §§ 16100, 16142 (Deering 1973 & Supp. 1977).

165. MICH. COMP. LAWS § 554.711 (MICH. STAT. ANN. § 26.1287(10) (Callaghan Supp. 1976)).

2. Strict controls should be placed on the development of designated land. If these controls exceed the limits of police power regulation, compensation should be paid to the owners, by such techniques as public purchase of development rights or the transfer of development rights. Funds for the public purchase of rights should be raised by the level of government which designates the eligible land, the major part of the funding coming from special levies on other land when it is developed. A capital gains tax covering at least a fifteen-year period would be one such levy.

The foregoing measures should prove sufficient to keep specified land out of development, but they will not necessarily be sufficient to keep it in agricultural use. To do that, additional policies would have to be enacted, perhaps including special incentives and subsidies. The detailing of such policies, however, lies far beyond the scope of this Article.