

CLEARING HOUSE RULE 05-063

ORDER OF THE DEPARTMENT OF REVENUE

The Wisconsin Department of Revenue hereby adopts an order to amend Tax 18.07(1)(b)1., 2., 3., (c)5., and Tax 18.07(3)(a); to create 18.07(1)(d)1. and 2.; and to repeal 18.07(1)(b)4., 5., 6., 7., (c)6., and 7, relating to the assessment of agricultural property.

ANALYSIS PREPARED BY THE DEPARTMENT OF REVENUE

Statutes interpreted

Sec. 70.32(2r)(c), Wis. Stats.

Statutory authority

Sec. 227.11(2)(a), Wis. Stats.

Explanation of agency authority

Each agency may promulgate rules that interpret the provisions of any statute enforced or administered by it, if the agency considers it necessary to effectuate the purpose of the statute.

Related statute or rule

Sec. 70.32(2r)(c), Wis. Stats.

Plain language analysis

Pursuant to sec. 70.32(2r)(c), Wis. Stats., agricultural land is assessed according to the income that could be generated from its rental for agricultural use. Wisconsin Chapter Tax 18 specifies the formula that is used to estimate the net rental income per acre. Income, expense, and value are determined by applying an owner-operator appraisal methodology. With an owner-operator method, net income is determined by deducting all operating costs and overhead from gross income. The formula specifies corn prices, cost of corn production, and corn yield for determining net income. Net income is capitalized to determine the agricultural use-value per acre. The capitalization rate is the sum of the interest rate for a medium-sized, 1-year adjustable rate mortgage and the municipal net tax rate for property taxes levied two years prior to the assessment year.

A landlord-tenant appraisal methodology is another means to estimate rental income. The basis for this method is an agreement or crop-share lease between a landowner (landlord) and a farm operator (tenant). Crop-share leases allow landowners and farm operator to share risk and management of a farm operation. The lease provisions will specify the distribution of income and costs. Typically, income and direct operational costs are equally distributed among the landowner and farm operator with the landowner assuming all property tax payments and the farm operator assuming all labor and machinery costs.

The rule order specifies the provisions of a crop-share lease for determining the net rental income per acre of agricultural land for 2006 and thereafter. The rule order includes the process and components for determining the landowner's share of gross income, cost of production, and net income.

Second, the rule order specifies a capitalization rate that is 11% or the sum of the interest rate for a medium-sized, 1-year adjustable rate mortgages and the municipal net tax rate for property taxes levied two years prior to the assessment year, whichever is greater.

Third, the rule order specifies that the annual change, either positive or negative, in use-values for 2006 and thereafter shall be limited to the percentage change in the statewide equalized value in the prior year. In determining the percentage change in the statewide equalized value, the value of agricultural land and the value of new construction are excluded.

Lastly, the rule order repeals subdivisions that are no longer applicable. Specifically, the subdivisions that specified the use-value calculations for 2004 and 2005 are repealed. Also repealed is a phrase allowing adjustments to the use-values that are determined by the Department. This phrase is repealed in order to ensure observance of the revised rule that specifies the commodity for determining net income and the percent that the use-values may change from one year to the next.

It is important to note that the rule order does not amend Tax 18.06 and the five categories of agricultural land, which are first grade tillable, second grade tillable, third grade tillable, pasture, and specialty land. The current process of calculating the yields for all three grades of tillable land and pasture land is maintained. All categories will be subject to the same aforementioned value change specifications. In addition, the rule order does not change the assessment procedures in the *Wisconsin Property Assessment Manual* for irrigated land and specialty land, which includes cranberry lands.

Summary of, and comparison with, existing or proposed federal regulations

Property taxation is governed by Wisconsin's constitution and statutes, as such there are no current or pending federal regulations regarding agricultural assessment.

Comparison with rules in adjacent states

The valuation of agricultural land in Illinois, Michigan and Minnesota are specified by statute; therefore, there are no administrative rules related to agricultural valuation in these states. The Iowa administrative rule related to agricultural valuation provides no detail regarding the formula used to calculate agricultural land value; reference is made to the Iowa real property appraisal manual.

Summary of factual data and analytical methodologies

The rule order specifies a landlord-tenant crop-share appraisal method to estimate the rental income of agricultural land. Under a crop-share lease agreement, a landowner provides the land and assumes the property tax expenses for the land. A farm operator provides the machinery, fuel, and labor. The landowner and farm operator share the direct operating expenses, including the seed, fertilizer, and pesticides or chemicals. Income from the harvested crop is also shared on the same basis as the direct operating costs. The rule order provides for an equal distribution of income and cost among the landowner and farm operator, which is reflective of a common crop-share lease.

Gross income, cost of production, and net income are determined based upon the following.

- Gross income is determined by multiplying the 5-year average corn yield by the 5-year average market price of corn. The result is reduced by 50% in order to determine the landowner's income under a crop-share lease.
- Cost of production is determined by multiplying the 5-year average direct operating costs of corn production by the 5-year average corn yield. The result is reduced by 50% in order to determine the landowner's costs under a crop-share lease.
- The landowner also incurs a management expense that captures the cost of maintaining and administering the operation. Management expense is 7.5% of the landowner's gross income.
- Net income is calculated by subtracting management expenses and direct operating expenses from gross income. Dividing net income by the capitalization rate provides the estimated value of agricultural land.
- Property taxes, which are a landowner responsibility, are realized in the capitalization rate.
- With the exception of the capitalization rate's municipal tax rate, all data is averaged over a 5-year period.

Analysis and supporting documents used to determine effect on small business or preparation of economic impact report

The department has prepared a fiscal estimate regarding the rule order. It was determined that there is not a significant fiscal effect on small business.

Effect on small business

The rule order does not have a significant effect on small business.

Agency contact person

Please contact Scott Shields at (608) 266-2317 or sshields@dor.state.wi.us, with any questions regarding the rule order.

TEXT OF RULE

SECTION 1. Tax 18.07(1)(b)1., 2., 3., are amended to read:

Tax 18.07(1)(b) *Net rental income per acre*. 1. Beginning in ~~1997~~ 2006 and in each year thereafter, net rental income per acre for each category of agricultural land in each municipality shall be calculated according to the income attributable to a landowner under a crop-share lease. The department shall assume a lease agreement where the income and direct operating costs are distributed equally between the landowner and farm operator. The department shall adhere to professionally accepted appraisal practices in determining gross income, cost of production, and net income that are attributable to a landowner under a crop-share lease. Net income shall be calculated by subtracting average total cost of production per acre under subd. 3. from average gross income per acre under subd. 2.

2. Beginning in ~~1997~~ 2006 and in each year thereafter, the landowner's average gross income per acre for each category of agricultural land in each municipality shall be calculated by multiplying the category's 5-year average corn yield per acre, adjusted for the typical productivity of that category, by the 5-year average corn market price per unit of output. The product shall be reduced by 50% to reflect a crop-share lease with equal distribution of income. Yield per acre shall be based on the federal soil conservation natural resource conservation service's soil productivity indices and corn market price data shall be obtained from the Wisconsin department of agriculture, trade and consumer protection. If the federal soil conservation natural resource conservation service and the Wisconsin department of agriculture, trade and consumer protection are unable to provide, or to provide timely, soil productivity indices and corn market price data, respectively, comparable data shall be obtained from other generally acceptable sources.

3. Beginning in ~~1997~~ 2006 and in each year thereafter, the landowner's average total cost of production per acre for each category of agricultural land shall be calculated by multiplying the category's 5-year average corn yield per acre, adjusted for the typical productivity of that category, by the 5-year average cost of corn production. calculated from farm expense information obtained from the Wisconsin department of agriculture, trade and consumer protection, the university of Wisconsin, federal agencies, or farm credit services associations. In calculating the 5-year average cost of corn production, the department shall include the direct operating costs incurred by the landowner under a crop-share lease, which shall include the cost of seed, fertilizer, lime, manure, chemicals, commercial drying, interest on operating capital, or their equivalent. The total cost of corn production is reduced by 50% to reflect a crop-share lease with equal distribution of direct operating costs. The 5-year average cost of corn production shall not include those costs incurred by a farm operator under a crop-share lease, which includes labor, opportunity cost of unpaid labor, machinery, fuel, repairs, overhead, or their equivalent. An additional landowner cost for operational management, equal to 7.5% of the average gross income determined in subd. 2., shall be subtracted from the average gross income calculation in subd. 2. Property taxes are not a farm expense for purposes of calculating average total cost of production per acre. Yield per acre shall be based on the federal soil conservation natural resource conservation service's soil productivity indices and cost of corn production data shall be obtained from the Wisconsin department of agriculture, trade and consumer protection. If the federal soil conservation natural resource conservation service and the Wisconsin department of agriculture, trade and consumer protection are unable to provide, or to provide timely, soil productivity indices and cost of corn production data, respectively, comparable data shall be obtained from other generally acceptable sources.

SECTION 2. Tax 18.07(1)(b)4., 5., 6., and 7. are repealed.

SECTION 3. Tax 18.07(1)(c)5. is amended to read:

Tax 18.07(1)(c) 5. The capitalization rate for each municipality for each assessment year shall be 11% or calculated by adding the sum of the statewide 5-year moving average rate for the year prior to the assessment year and to the net tax rate of that municipality for the property tax levy 2 years prior to the assessment year, whichever is greater.

SECTION 4. Tax 18.07(1)(c)6. and 7. are repealed.

SECTION 5. Tax 18.07(1)(d)1. and 2. are created to read:

Tax 18.07(1)(d) 1. Beginning in 2006 and in each year thereafter, increases and decreases in the use values for each category of agricultural land in each municipality shall be limited to the prior year's percentage change in the statewide equalized value. When determining the percentage change in the statewide equalized value, the department shall exclude the value of agricultural land and new construction. New construction shall include increases in land value due to higher land use, new subdivisions, and increases in improvement value due to new construction, completion of improvements partially assessed, remodeling and additions, and land improvements such as addition of curb, gutter, sewer, water, or their equivalent. The amount of new construction shall be reduced by the loss of land utility and loss of property value due to full or partial destruction, removal, contamination, or their equivalent.

2. The department shall calculate the percentage change from the previous year's use-values to the current year's use-values according to the formula in s. Tax 18.07(1)(b). Increases and decreases in the use values for each category of agricultural land in each municipality shall be limited to the percentage change determined in subd. 1. If the increase or decrease is less than the percentage change determined in subd. 1, the use value per acre will equal the value calculated by the department according to the formula in s. Tax 18.07(1)(b).

SECTION 6. Tax 18.07(3)(a) is amended to read:

Tax 18.07(3)(a) The assessor shall determine the use value of each parcel of agricultural land based on the use value per acre for that category of agricultural land in that municipality provided by the department, ~~adjusted by the assessor to reflect more accurately the use value of that parcel of agricultural land.~~

This rule shall take effect on the first day of the month following publication in the Wisconsin administrative register as provided in sec. 227.22(2)(intro), Wis. Stats.

DEPARTMENT OF REVENUE

Dated: _____

By: _____
Michael L. Morgan