12-1-1975

Considerations for rollback provisions for South Dakota's use-value assessment of agricultural Lands

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CONSIDERATIONS FOR ROLLBACK PROVISIONS FOR SOUTH DAKOTA'S USE-VALUE ASSESSMENT OF AGRICULTURAL LANDS

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PREFACE

The assessment of agricultural lands in South Dakota must be based on its use-value or productivity in agriculture rather than full market values. Suggestions have been made that the law should include rollback provisions to discourage speculative land purchases and to control urban sprawl.

How effective are rollback provisions in achieving these ends? How are farm and nonfarm taxes affected by these provisions?

This research bulletin develops a decision making framework for this public affair issue. The purpose is to educate rather than to advocate a particular solution.

This research was completed pursuant
to the objective of Title V of the Rural
Development Act of 1972.

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December 1975

CONSIDERATIONS FOR ROLLBACK PROVISIONS FOR SOUTH DAKOTA'S USE-VALUE ASSESSMENT OF AGRICULTURAL LANDS

Economic growth and increased population have lead to significant land use problems and conflicts in some parts of the United States. While most of the cities and counties in South Dakota have not been experiencing rapid population increases, there has been rapid growth in selected urban areas of the state. There is concern among numerous individuals that land use policies be studied at an early stage, before land use problems become pressing

Use-value assessment is a widely used practice that may influence land use policy. Use-value assessments, sometimes also called differential assessment, are based on the net income generating capacity of the land rather than its market value which may also reflect urbanization pressures or inflationary trends. Differential assessment taxation has frequently been suggested as a policy tool for influencing the rate of conversion of agricultural land to nonagricultural uses, as well as for controlling the extent of urban sprawl.

The basic motivation for adopting a use-value tax for agricultural lands varies in each of the thirty-seven states which have some form of this tax. Other than influencing land use, some of the motivations for use-value taxation are to provide property tax relief to farmers, to establish uniform property assessment procedures and to maintain open spaces in densely settled metropolitan areas.

In 1970 the South Dakota legislature approved an assessment procedure for agricultural land based on consideration of the following factors [S.D. Compiled Laws (SDCL) 10-6:33.1]:

(1) The capacity of the land to produce agricultural products;

(2) Soil, terrain and topographical condition of the property;

(3) The present market value of said property as agricultural land;

(4) The character of the area or place in which said property is located; and

(5) Such other agricultural factors as may from time to time become applicable.

The law does not specify the actual procedure to be utilized in determining "the capacity to produce agricultural products" although it did specify the sources of information in detail.

A procedure was developed by soil scientists at South Dakota State University which employs sales values on unimproved agricultural lands and data on soil capability sub-classes to estimate the value of agricultural lands.(15,16)[1/]

In 1974 the State legislature adopted the following article:

> Land devoted to agricultural use shall be classified and taxed as agricultural land without regard to the zoning classification which it may be given; provided, however, that all or any portion of such land which is sold or other wise converted to a use other than agriculture shall be classified and taxed accordingly. (SDCL 10-6-31:1)

1/ The numbers in parenthesis indicate the reference cited.

In the 1974 session of the State legislature this assessment law was amended so that subdivision 3 of SDCL 10-6:33.1 reads:

> (3) The present market value of said property as agricultural land as determined by the factors contained in subdivisions 1, 2, 4 and 5 of this chapter.

This paper does not go into the issue of how the use-value should be determined, but rather explores alternative provisions related to the rollback issue. Readers interested in a detailed discussion of alternative methods of assessing agricultural lands should see South Dakota State University's Experiment Station Bulletin 639: "Alternative Evaluation Procedures for South Dakota's Use-Value Assessment of Agricultural Lands."

I. Objectives of this Bulletin

The objective of this bulletin is to provide information related to the rollback provisions of use-value taxes. Two basic forms of rollback provisions exist: deferred taxation and restrictive agreements. Briefly these involve payment of back taxes if agricultural land is sold for non-agricultural uses. (A detailed discussion follows on page 13.) Suggestions have been made at several levels of government that the law should include some form of rollback tax to discourage speculative land purchases. The basic question which legislators and voters must ultimately decide is: Should South Dakota modify its use-value tax to incorporate either a deferred taxation provision or a restrictive agreements provision?

Public decisions about taxes or other public issues involve three considerations: the facts, what people think are the facts and value judgments or political decisions. This bulletin attempts to describe and clarifies the alternative provisions for rollback provisions and the consequences of each type of provision. However, the decisions on whether the state law should be modified, and if so, how it should be changed, are political decisions rather than scientific. Thus no recommendations will be made in this regard. The information provided on this tax will be useful in evaluating the relative merits of the alternative tax arrangements.

First, the extent of South Dakota's problems toward which use-value taxation is directed is surveyed. Second, the manner of determining the use-value assessment is described. Third, differences in the three rollback provisions for use-value taxation are described. Fourth, the experience of its use in other states is explored. Finally, the alternatives open to South Dakota with respect to the rollback provisions of the use-value tax are summarized.

II. Extent of the Land Use and Tax Equity Problems in South Dakota

In the United States 6.1 percent of the farmland was removed from agriculture from 1950 to 1972. This has generated concern about the rate of conversion of agricultural land to urban uses. While the increased productivity of cropland has kept this from affecting the total agricultural output, the distribution of this reduction may create some problems. As Figure 1 shows, much of the conversion has been on the east coast of the United States. Seventeen states have lost over 20 percent of their farmland and two have lost over 50 percent.

As Figure 1 shows, South Dakota lost only one percent of its farmland from 1950 to 1972. Table 1 shows the change in farmland from 1964 to 1969 by planning districts in South Dakota. While the change in acreage in agriculture was slightly positive for the entire state, there was some reduction in four districts. Figure 2 shows the change for each county from 1964 to 1969.

Is this a problem, or is it a sign of progress? Will this reduction in agricultural lands result in serious reductions in food supplies? Although 3.19 percent of the First District's land was removed from farm production from 1964 to 1969, the productivity of cropland increased by 7 percent during this period.(14) While the total output increased over this period, there was a reduction of the potential agricultural output. No scientific conclusions can be drawn about the desirable level of agricultural output, but there is popular concern with the preservation of the better agricultural lands from urban encroachment. Due to the small reductions in agricultural lands in South Dakota, the loss of agricultural land does not appear to be a serious problem.

Urban sprawl in the form of strip development and leap frog development is becoming more common around South Dakota's growing cities. Strip development is the development of a single line of homes along a highway that run out of the city. Leap frog development refers to a situation where agricultural land separates the city and a new residential development.

Both of these forms of urban sprawl are creating concerns that this will lead to increasing costs of providing city services such as fire and police protection, sewer and water lines.[2/] Others are concerned that leap frog development may result in conflicts of interests between agricultural producers and surrounding residences due to the existence of dust and noise.

[2/] The total investment costs for the construction of residential dwellings, highways, utilities, public facilities and schools have been estimated to be 44 percent lower in high density communities than in communities with low densities and leap frog patterns for siting neighborhoods. The public costs for roads and utilities were 55 percent lower in the high density communities than in the low density ones.

How widespread is urban sprawl in South Dakota? While no objective method exists for measuring the extent or rate of growth in urban sprawl in South Dakota, strip and leap frog developments are increasingly more common.

The extent of sprawl is correlated to the population growth in urban areas. Table II shows the rate of growth of the thirteen South Dakota cities having moderate to very rapid growth from 1960 to 1970. These are the areas where urban sprawl would most likely be seen. However, even in areas with slow growth or population declines, new building does occur and may result in strip development.

Higher taxes are a third problem stemming from leap frog or strip development. When assessments are determined by the sales value of comparable lands, urban sprawl frequently leads to higher assessments for farmland on the urban-rural fringe. Likewise, the higher costs for public services are partially shifted to neighboring farmlands.

Taxes per acre have increased over 259 percent from 1955 to 1973 as Table III shows. The rate of increase in farmland value from 1955 to 1973 was 242 percent compared to 594 percent increase in net farm income.(14) Despite these increases in net farm income, information is needed on the equity of tax payments between farm and non-farm taxpayers.

Tax equity is a reason frequently advanced as a rationale for use-value taxation of agricultural lands. Before examining South Dakota's situation, it is necessary to define the term tax equity. Two criteria are common in measuring tax equity: (1) different groups share the tax burden in proportion to the benefits received from the public sector, and (2) different groups share the tax burden in direct relationship to their ability to pay.

TABLE I

CHANGES IN THE AMOUNT OF LAND IN AGRICULTURE 1964-1969, BY DISTRICTS, OF THE STATE OF SOUTH DAKOTA

District	1969	1964	Difference	Percent
I	4,003,018	4,134,780	-131,762	-1.18
II	2,071,270	2,110,180	- 38,910	-1.84
III	4,869,078	4,936,750	- 67,672	-1.37
IV	7,441,613	7,481,075	- 39,462	- .52
V	15,781,394	15,688,995	+ 92,399	+ .58
VI	11,417,791	11,215,720	+202,071	+1.80
State	45,584,164	45,567,500	+ 16,664	+0.04

Source: 1969 Census of Agriculture, Volume 1, Area Reports.

The benefit approach to equity would have property tax revenues spent on services that directly affect property owners and their property. The primary source of public support for elementary and secondary education is from property taxes. Since many of the students receiving public education can be expected to leave their home district and take the social benefits of education with them, property taxation is inequitable when judged by the benefit criteria.

The ability to pay taxes can be measured by the taxpayer's income, or his net worth. The individual's net worth is simply the value of his assets minus liabilities. Ideally all forms of assets such as real property, personal property, and intangible properties, i.e., stocks, bonds or notes would be considered. Data were not available on the net worth by county for agricultural and non-agricultural sectors.[3/] Consequently only income will be considered as a measure of ability to pay.

Data on the percentage of personal income paid in property taxes for both the agricultural and non-agricultural sectors are shown in Table IV. Personal income data utilized here includes all gross wages, rents, interests, profits and transfer payments (welfare, Social Security, etc.). This income definition differs from that used for federal income tax purposes. As Table IV indicates the

3/ There are data on the percent of full property value taxed away for both sectors in 1969. This indicates that rural properties paid only 1.46 percent of their full market value compared to 3.12 percent for urban properties. This value is not the same as net worth, however, since liabilities are not considered at all. Thus it is difficult to interpret this data.

agricultural sector paid 11.1 percent of its personal income in property taxes compared to 5.2 percent for the non-agricultural sector. While there is considerable year to year variation in the percentage of agricultural income paid in property taxes in South Dakota, they have not fallen below 6.6 percent since 1953.(13)

In summary it appears that the primary reason to consider use-value taxation in South Dakota is to improve tax equity between farm and non-farm taxpayers. Urban sprawl and the associated higher public costs are secondary factors which provide an additional rationale. There appears to be little reason for concern about the loss of agricultural lands in most of the state.

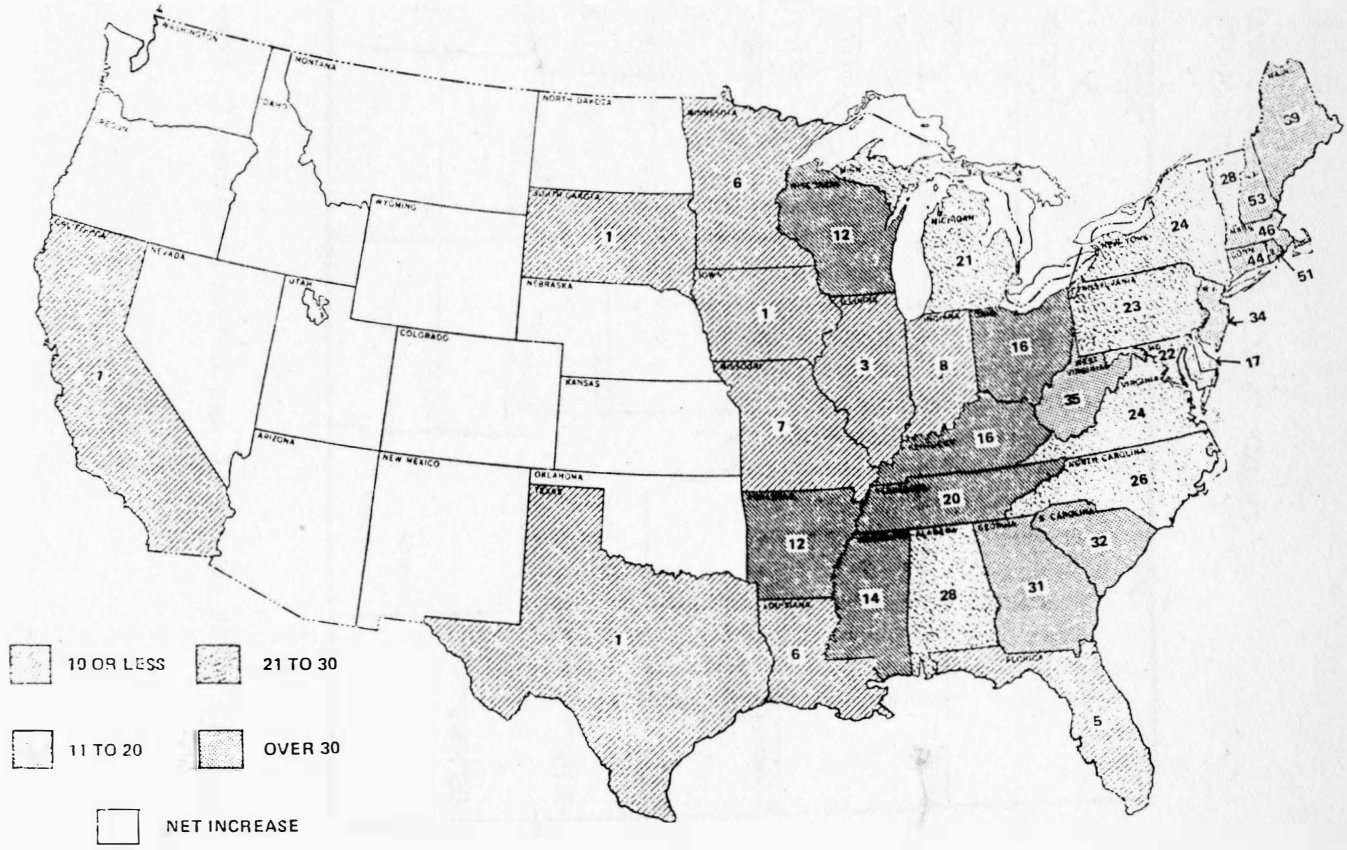
III. The Determination of the Use-Value Assessment

Regardless of the type of use-value tax, it is necessary to clearly understand how the use-value of agricultural land is to be determined. There are two basic ways that the use-value of agricultural land can be determined: comparable sales and capitalization of earned income.

The first method simply separates agricultural sales from non-agricultural sales and then uses only the agricultural sales as an assessment criteria. Soil scientists at South Dakota State University and the Soil Conservation Service have developed a detailed procedure for utilizing sales

FIGURE 1

DECREASES IN ACRES OF TAXABLE FARMLAND, BY STATES, 1950-1972 (Percentages)

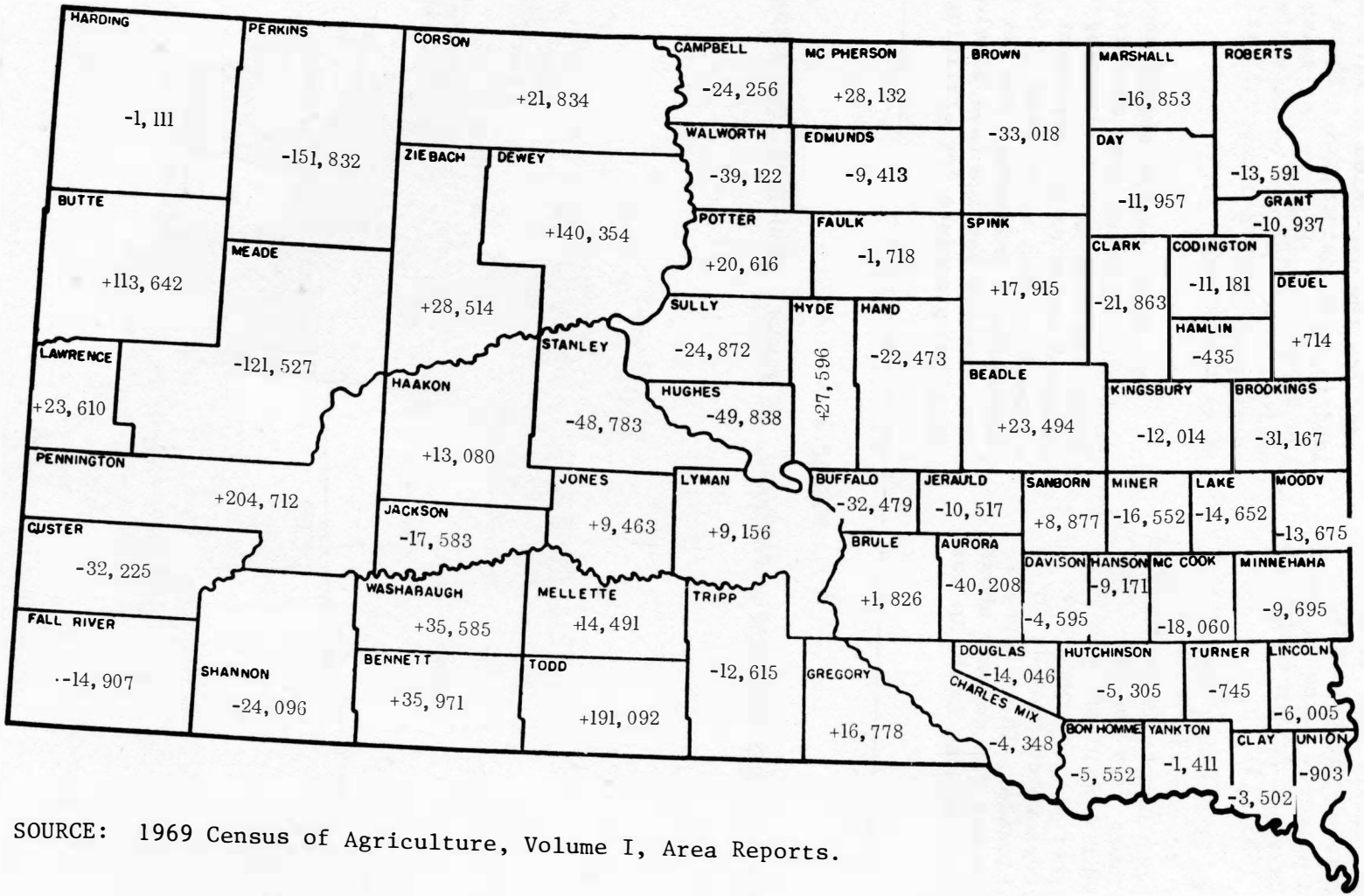


SOURCE: U.S. Department of Agriculture, Economic Research Service, "Farm Real Estate Taxes" (Washington, D.C.: U.S. Department of Agriculture, March 1974), pp. 5-8.

NOTE: Figures were calculated by dividing total farm real estate taxes by taxes per acre for 1950 and 1972 respectively and computing the percentage change.

FIGURE 2

CHANGE IN ACREAGE IN AGRICULTURAL USE FROM 1964 TO 1969
BY COUNTY, SOUTH DAKOTA



SOURCE: 1969 Census of Agriculture, Volume I, Area Reports.

on unimproved agricultural lands and productivity ratings on soil sub-classes.(15, 16) It starts with data on land sales from unimproved agricultural lands and estimates the unimproved sales value of 17 land sub-classes. This then permits the local assessor to estimate the use-value of any farm using a detailed soil map. The local assessor only needs to multiply the conceptual dollar values which have been estimated for his county by the number of acres of land in each of the 17 land subclasses. These are added together for the farm's total assessed value.

The second method of determining the use-value of agricultural land is the capitalization of the net income attributable to land. To determine the capitalized property value, one determines the net farm income attributable to land and then divides it by a fair rate of return. There are several ways to actually estimate the net income to land. Data on the landlord's crop share and landlord expenses can be used to determine the net return per acre. Alternatively enterprise budgets can be constructed by typical crop rotations. Both of these can be used with soil productivity classes.

TABLE II

MODERATE TO RAPIDLY GROWING CITIES IN SOUTH DAKOTA, 1960 to 1970

	Change in Population	Growth Rate (percent)
Cities with Very Rapid Growth		
Urban Part of Minnehaha County	1,542	138.2
Pine Ridge	2,700	117.0*
Martin	960	75.0*
Vermillion	3,026	49.6
Brookings	3,159	29.9
Yankton	2,640	28.5
Spearfish	979	26.6
Cities with Fast Growth		
Madison	895	16.5
Aberdeen	3,403	14.7
Sioux Falls	7,022	10.7
Cities with Moderate Growth		
Mitchell	870	6.9
Milbank	227	6.5
Canton	154	6.1

Sources: Riley, Marvin P. and Robert T. Wagner, South Dakota Population and Net Migration 1960-1970, Bulletin 580, February 1971, Agr. Experiment Station, SDSU, Brookings.

*Gustafson, Neil C. Recent Trends/Future Prospects: A Look At Upper Midwest Population Changes, Minneapolis Upper Midwest Council, January 1973.

Another alternative is to determine the net return per acre of each crop. This net return per acre is utilized to estimate the average net return for an entire farm.[4/]

IV. Rollback Provisions of Use-Value Taxes

The rollback tax is the difference between the taxes based on use-value and the taxes based on market value. Rollback taxes are only paid if the land is changed from agricultural to non-agricultural use. If this change occurs, the landowner must pay back taxes for a number of years on the differential in taxable value between assessments based on market value and use-value. In other words, when the law has a rollback provision, taxes are lower for the period of time the land is in agriculture. But if land is removed from agriculture rollback taxes must be paid. That is, the taxes are just deferred until the time the land is used for non-agricultural purposes. Taxes are due at the time the property is sold and thus the cash for paying rollback taxes is usually available. Thus it makes it easier to pay the property tax than if the tax was assessed on full market value while in agriculture. Tax revenues are available to local governments at the time they need them to put in new streets, sewers, water and pay for other services. This form of differential assessment, which includes the rollback tax, is also deferred taxation. In sixteen states, rollback taxes must be paid when the land is sold or changed from agricultural use to non-agricultural use.

In South Dakota and nine other states, farmers do not have to pay rollback taxes when they sell the land for non-agricultural uses. This type of differential assessment is generally called preferential assessment.

Five states, Hawaii, California, Maine, Pennsylvania and Vermont have what is called restrictive agreement use-value taxation. Restrictive agreements are a form of contract zoning. This is an agreement between the owner of the land and local government. The procedure is simple. The landowner enters into an agreement that he will keep his land in agriculture for a specified period of time and his reward for doing this is an assessment based on use-value rather than potential value.

If the landowner changes the use of his land prior to the end of the period of agreement, the states that use a restrictive agreement provision fine the landowner in addition to the rollback taxes. For example in Hawaii, if you change the use of your land within the 10 year contract period, you are fined 10 percent of the deferred taxes. Washington state has a penalty of 20 percent of the rollback taxes if the owner fails to give two years notice of the change in land-use.

So in a sense a farmer can sell his land at any time under all three types of use-value tax, but the cost of doing so becomes more expensive as we move from the preferential type of tax to the deferred taxation and to the restrictive agreement type.

In summary, there are three types of rollback provisions for differential assessment: preferential, deferred taxation and restrictive agreements.

Restrictive agreements involve not only use-value assessment, but contractual zoning which does not permit a farmer to sell his farm land until the end of the contract period without paying a penalty tax. Deferred taxation is where the farmer can sell his land at

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[4/] For a more detailed discussion of these four alternatives see Morse, George W. "Alternative Evaluation Procedures for South Dakota's Use-Value Assessment of Agricultural Lands." Economics Department, Bulletin B639, South Dakota State University, September, 1975.

TABLE III

VALUE OF FARM REAL ESTATE AND TAXES
TAXES LEVIED PER ACRE, SOUTH DAKOTA, 1950-74

Year	Net Income Per Acre	Total Value Per Acre*	Taxes Levied Per Acre
1955	2.74	40.00	.54
1960	4.99	51.00	.69
1965	5.30	62.00	.82
1970	5.69	84.00	1.27
1971	6.08	85.00	1.35
1972	10.28	89.00	1.39
1973	19.02	97.00	1.40

*Total value of land and buildings.

SOURCE: South Dakota Agricultural Statistics, Crop and Livestock Reporting Service Bulletin, 1974, p. 65 and Farm Income, State Estimates 1949-73, Economic Research Services, USDA, September 1974.

any time, but when he does sell it he must pay the rollback tax equal to the tax break which he received while the land was in agriculture. Preferential assessment says a farmer can sell his land at any time for non-agricultural uses and he does not have to pay any type of rollback tax. States using each of these are shown in Table V.[5/]

V. Land Use and Tax Incidences Impacts - The Experience of Other States

How effective is each form of use-value tax in preserving prime agricultural lands? Do they encourage land speculation on the urban-rural fringe? Do they really shift taxes to the rural non-farm population? If so, by how much? Do they lower the taxes farmers have to pay? While no research is currently available for these questions in South Dakota, a look at the actual experience of other states that have for some time had use-value taxation in operation may be of value.

Impact on Preserving Agricultural Lands and Its Effect on Urban Sprawl

Two of the above questions will be considered in this section. They are: Does the preferential use-value tax reduce the speed at which agricultural land is sold for non-agricultural uses by removing the tax pressures and thus increase farmer's ability to stay in farming? Is the rate of growth or urban sprawl reduced by the utilization of a preferential use-value tax?

[5/] See Gloudemans, Robert J. "Use-Value Farmland Assessments: Theory, Practice and Impact." International Association of Assessing Officers, Chicago, 1974 for a more detailed discussion of rollback provisions.

These are difficult questions to answer because land conversions are affected by many factors besides the tax burden. For example, land sales are affected by such things as the rate of appreciation of all lands, the amount of urban growth in the area, interest rates, the availability of mortgages and the age structure of the farm population, in addition to taxation.

It was found that little or no research has been done on the impact of agricultural land use in the states having preferential assessment laws similar to South Dakota. However, under the preferential assessment the landowner can sell his land at any time for a non-agricultural use, but if he continues to farm the land he will continue to pay lower taxes than if it is taxed at full market value. Also, especially on the urban rural fringe, he may eventually sell the land for several times its value in agriculture. In this case, he could realize what is called a "windfall gain." This encourages speculators to buy up land on the edge of cities. On the other hand, some farmers may refuse to sell until much later to capitalize on the rising land prices and lower taxes. A combination of these actions may encourage leap frog development. Thus the preferential use-value tax may actually speed up the growth of leap frog or strip developments, even if it slows down the removal of land from agricultural use.6/

6/ Theoretically a distinction can be made between lands whose current return in non-farm use exceeds the current return to farming and those whose current plus future returns in non-farm enterprises exceed farm returns over the entire period. In the former case there is more incentive to change uses than in the latter. Use-value taxes may slow the rate of conversion in the latter by increasing the net return to agricultural uses.

Would either the deferred taxation or the restrictive agreement form of use-value assessment help slow down the removal of land from agriculture and reduce the growth of urban sprawl? First the deferred taxation option is considered. Recall that under deferred taxation, land is assessed at its use-value while it is in farming, but is then charged for all the differential between the market value and use-value once the land is used for non-agricultural uses.

Research in Maryland indicates that deferred taxation does not help preserve agricultural lands. This isn't a very surprising result. Use-value taxation is a monetary incentive which encourages a farmer to keep his land in agriculture. But on the other side is the capital gain he can receive from selling it for non-agricultural uses. Usually, the capital gains incentive far out-weighs the tax saving incentive. In Maryland the expected gains were from seven to fifty times the tax break.(7)

Unlike the preferential use-value tax, a strong rollback provision may provide less encouragement for speculation, since the full tax burden must be paid at the time land is removed from agriculture. The degree to which speculation is discouraged depends on market forces. The increased tax burden may be shifted back to farmers by paying less for the land or forwarded to developers by charging them more for the land. The extent to which this will occur depends on how responsive these two groups are to changes in the price of land.

Restrictive agreements are binding contracts with local governments not to convert agricultural land. In compensation the landowner receives a use-value assessment rather than the standard market value. If the contract is broken, however, both rollback taxes and penalties are paid.

TABLE IV

PROPERTY TAXES AS A PERCENTAGE OF PERSONAL INCOME FOR THE AGRICULTURAL AND NON-AGRICULTURAL SECTORS, BY PLANNING AND DEVELOPMENT DISTRICTS, SOUTH DAKOTA, 1969

	Agricultural Sector (percent)	Non-Agricultural Sector (percent)
District I	15.1	5.9
District II	10.5	5.7
District III	9.8	6.4
District IV	12.8	7.4
District V	7.3	5.8
District VI	10.4	5.0
State	11.1	5.2

Source: Kent, Calvin A. and Allyn O. Lockner, "Property Taxes and the Circuit Breaker." Institute of Public Affairs, University of South Dakota, Vermillion, September 1971.

Research in California, which has a restrictive agreement provision, indicates that valuable land which is likely to be sold for non-agricultural purposes was not enrolled in the use-value taxation program.(3) Current research shows that only a small percentage of the farm land within three miles of a city is enrolled in the tax program.(5) This suggests that farmers within this three mile area think they may sell their land for non-agricultural use before the ten years is up.

The restrictive agreement use-value tax does not entirely discourage urban sprawl and the removal of land from agriculture. There is some research evidence that counties which have used zoning rigorously in conjunction with use-value taxation are able to preserve agricultural lands.(5) This means that only lands zoned for agriculture can receive the differential assessment.

When land is zoned strictly for agricultural uses, the market value will eventually fall to the capitalized value of the net agricultural income attributable to land. This occurs because its market value will reflect only what the land is worth in agriculture since it cannot be changed to other uses. In this situation the use-value taxes are used as a means of partially compensating farmers for any losses in their net worth.

The South Dakota law reads, "Land devoted to agricultural use shall be classified and taxed as agricultural land without regard to the zoning classification which it may be given...." (SDCL 10-6-31.1). This does not rule out exclusive agricultural zoning even though there is little incentive for farmers to support this since they can currently be taxed as agricultural lands without this strict form of zoning.

TABLE V

THREE ROLL-BACK PROVISIONS FOR USE-VALUE TAXATION OF AGRICULTURAL LANDS BY STATES

Preferential Assessment	Deferred Taxation	Restrictive Agreements
Arkansas	Alaska	California
Colorado	Connecticut	Hawaii
Florida	Delaware	Maine
Indiana	Illinois	Michigan*
Iowa	Kentucky	New York
Louisiana	Maryland	Pennsylvania
New Mexico	Massachusetts	Vermont
North Dakota	Minnesota	Washington
South Dakota	Montana	
Wyoming	Nebraska	
	New Hampshire	
	New Jersey	
	North Carolina	
	Ohio	
	Oregon	
	Rhode Island	
	Texas	
	Utah	
	Virginia	

*Michigan's differential assessment law is unique in that it combines the circuit breaker concept with a restrictive agreement. If a Michigan farmer enters into a development rights agreement to keep his farmland as farmland for at least ten years, he will receive a rebate for property taxes in excess of 7 percent of household income.

SOURCE: B. L. Flinchbaugh and Mark Edelman, "Use-Value Assessment Case Studies: Colorado, Maryland, California, and Kansas" Cooperative Extension Service, Kansas State University, Manhattan, February 1975.

In conclusion, most of the available research indicates that neither the rollback nor the restrictive agreement use-value tax provisions, when used alone, help slow down the removal of land from agriculture or to reduce the growth of urban sprawl. However, in this respect, these two forms of the tax may be superior to the preferential tax since they may discourage speculation which may lead to more rapid removal of lands and growth in urban sprawl.

The only effective control for keeping land in agriculture and reducing urban sprawl appears to be to zone the land as strictly agricultural and then utilize the use-value assessment to partially compensate landowners for gains not realized in property values.

Impacts on Farm Taxes

Will my taxes per acre fall and by how much once use-value taxation is adopted? This is a question many farmers have on their minds.

This depends on several factors. First, it depends on the level and the date of the last farm assessment when the use-valuation taxation goes into affect in the county or township. Second, it depends on whether or not the county is planning to reassess all properties regardless of the adoption of a use-value taxation. Third, it depends on the difference between use-value and market value. Fourth, if use-value assessments are lower than the old assessment, it depends on how much the mill rate has to change to make up for lower assessments on agricultural lands.

If the land is in an area where the assessments are old, the use-value assessment might actually be equal to or higher than the present assessment. This appears to be the case in some counties in South Dakota.

This comparison of old market value and new use value assessments is not the correct one. The important question is: If my farm had up-to-date market value assessments how would it compare to the use-value assessment? If the farm land is in an area where the assessment is up-to-date, or if a reassessment is ordered to update it, then the use-value assessment will be equal to or lower than the market value assessment.

The difference between new use-value assessments and new market value assessments is directly related to the urban demands for land. Tracts near growing urban areas will have wider differences between their market value and use-value. In counties with declining cities there will be very little urban demand for land and consequently little difference between market value and use-value. There may not be much of a decline in either assessments or taxes in very rural counties. If agricultural lands constitute quite a large proportion of the tax base, the increase in mill rates may hold agricultural taxes up even though assessments fall.

In summary, we would expect many of the new assessments on agricultural lands in South Dakota to rise due to the old age of the market value assessments. However, compared to the assessment level farmers would face without a use-value tax, these new assessments will be lower around cities with recent growth. Table II shows the 13 areas in South Dakota with moderate to very fast population growth rates. Farmland near the fringe of these cities is likely to have a lower use-value assessment than new market value assessments. There is not likely to be much difference in the assessments in rural areas.

How will the rollback provisions affect farm taxes? The direct effect of any form of rollback is only seen when land is changed from agricultural to non-agricultural use. In this case the landowner must pay back taxes for a number of years on the differential between the market's taxable value and the use-value taxable value.

The additional revenue generated by the rollback taxes means that changes in the mill rate will be influenced. In areas where the use-value assessments exceed the old market value assessments the mill rate will decline more when there are rollback provisions than under the preferential provisions. Thus the remaining farmers who do not sell their land will receive a slightly greater tax benefit from rollback provisions. Farmers, or land speculators, that do change the use of their land to non-agricultural activities will pay more under rollback provisions than under the preferential provisions.

Likewise in areas where the use-value assessment is less than the old market value assessments, the increase in mill rates will be more moderate under rollback provisions. Again, remaining farmers will receive a slight tax break while those farmers or speculators who sell their land for non-agricultural uses will not.

Impacts on the Taxes of Non-Farmers

If farmers pay lower taxes as a result of use-value taxation and local governmental budgets remain the same, non-farmers have to pay for this. Since many of the new assessments for farmland may rise, even though less under a use-value assessment than under a full market assessment, it is unlikely that the non-agricultural sector will have to pay higher rates than previously. However, non-farmers will pay more taxes under a use-value assessment than under new full value assessments. This potential shift is larger in smaller cities with rapidly growing urban-rural fringes since there is less non-agricultural tax base over which to spread the tax shift.

The extent of tax shifting to the non-agricultural sector will be less when rollback provisions are utilized. This occurs because some additional revenue is generated whenever the rollback taxes are collected.

When land is changed from agricultural to non-agricultural uses, there are frequently additional demands upon governmental services. Streets and roads must be improved. Sewer and water lines are usually installed. School children must be educated. These additional costs are balanced somewhat by rising assessments on the land and improvements. The greatest revenue boost comes when the rollback provisions for use-value taxes are utilized.

If the rollback taxes are shifted forward to the land purchaser, than the new urban users of land bear the cost of this tax. In this case, those that continue farming, the non-farm residents of older parts of the urban area, and even the farmer who sold are not penalized (or at least to a lesser degree) by the increasing urban costs resulting from this expansion. Rather the new urban users pay for more of the additional costs which they impose on the area. If the market will not permit the rollback taxes to be shifted forward, then the farmer selling the land bears this cost directly. Since this occurs at a time when he has just received payment for his land, this is less of a burden than payments made out of annual farm income.

VI. Summary of Policy Questions Facing Each County

The present law reads: "Land devoted to agricultural use shall be classified and taxed as agricultural land without regard to the zoning classification which it may be given...." (SDCL 10-6-31.1)

Currently fifteen counties have already instituted use-value taxation in at least one or more townships. These counties are: Minnehaha, Brookings, Codington, Spink, Hughes, Roberts, Turner, Gregory, Hamlin, Brule, BonHomme, Clay, Dewey, Lincoln, and Pennington.

The law does not have any sanctions for not adopting use-value immediately. The speed at which a county adopts this is apparently a local decision. So, each county is faced with the question of how rapidly they should adopt the preferential use-value taxation which the present law provides for.

In addition, each county faces the question of whether the law should be changed to permit counties to utilize restrictive agreements or deferred taxation form of use-value taxation, if the county desires.

The effectiveness of alternative forms of use-value taxation in keeping land in agricultural use, in reducing urban sprawl, and in changing farm and non-farm taxes has been reviewed. But the decisions on how rapidly to adopt this form of use-value taxation or to seek rollback provisions requires not only the information presented here but also involves value judgments about trade-offs between tax equity and land-use. No recommendations can be made on which policy is desirable. The decisions will probably vary from county to county.

There are many other approaches to both tax equity and influencing land use on the urban-rural fringe. Tax equity can be addressed via taxation policies that (1) reduce reliance on the property tax as the principal source of local revenues, or (2) utilize circuit breaker provisions which provide rebates when property taxes exceed a certain percentage of household income. The reduction of urban sprawl, i.e., strip development or leap frog development, can be addressed by policies that: (1) place all property taxes on land alone (site-value taxation), (2) zoning, (3) development of agricultural districts, and (4) controls on the extension of publicly supported water systems and sewer lines. While all these could not be considered in this report, they need to be considered and studied for the final decision making process.[7/]

[7/] For a discussion of alternative means of reducing urban sprawl see: Morse, George "Alternative Policies for Controlling Urban Growth on Agricultural Lands." Economics Department, South Dakota State University, 1975.

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Published in accordance with an Act passed in 1881 by the 14th Legislative Assembly, Dakota Territory, establishing the Dakota Agricultural College and in the Act of re-organization passed in 1887 by the 17th Legislative Assembly, which established the Agricultural Experiment Station at South Dakota State University.

600 copies printed at an estimated cost of 24¢ each--12-75--