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Economic implications of differential taxation for agriculture in the Intermountain West: Issues and Alternatives[1]

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Executive Summary

Private lands occupy the most biologically diverse portions of the landscape in the Intermountain West, provide more than 80 percent of the critical habitat of about half of America's threatened or endangered wildlife species, sustain food and fiber production, source and purify drinking water, and protect important riparian resources. These lands also provide recreational opportunities and scenic values, create a transition and connectivity between developed communities and public wildlands, and provide an economic foundation for Western communities.

All states in the Intermountain West assess farms and ranches at their agricultural use value. Some states extend some form of preferential use value assessment to land managed for its value for wildlife, natural resource conservation, outdoor recreation, and open space – not just for commodity production. Property tax laws and assessment practices in other states create obstacles for landowners who want to manage their private land for natural resource conservation or diversified, land-based revenues.

In some cases, property tax structures run directly contrary to financial incentives provided by federal, state and local governments. For instance, a landowner who agrees to reduce livestock grazing due either to drought or in partnership with state wildlife recovery or watershed protection efforts may no longer qualify for agricultural tax classification. These tax policies also undermine economic opportunities for landowners who seek to diversify income streams by managing for multiple objectives (e.g. ecosystem services payments or eco-tourism).

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Adjustments in property tax codes to accommodate these important emerging trends in agriculture and sustainable land management should be considered. As a result, the purpose of this project is to evaluate the potential of reforming property project is to evaluate the potential of reforming property tax structures in the Intermountain West to provide for more diversified revenue opportunities on working lands, improved opportunities for wildlife and natural resources management, the protection of intact agricultural and open space lands, and economic benefits for local communities.

This report has four general sections:

1. A comparative review of differential agricultural taxation laws in Arizona, Colorado, New Mexico, Utah and Wyoming.
2. A discussion of the potential dimensions of proposed revisions to current laws to enable the treatment of agricultural lands under such legislation to include management for wildlife habitat, open space and other publicly valued rural land attributes, as adopted by other Western states.
3. A review of the potential dimensions of economic impact due to enabling diversified management of agricultural land use, as well as the likely implications of stricter compliance with the current agricultural use taxation laws relative to the current situation or 'baseline' case.

An illustrative estimate of the economic impact of the potential changes on the states of Colorado, New Mexico and Utah is provided, including hypothetical representative ranches in high growth, high amenity rural counties of each of these states.

Section 1: Agricultural Use Value Taxation in the Intermountain West

All states offer some type of use value assessment program for land used in agriculture. The programs are a response to concerns that high development pressure, primarily near residential areas, will result in higher property values, higher assessments, and more property taxes paid on agricultural lands. The intent of the programs is to reduce the tax cost of owning land that is in productive use, and thereby lower the likelihood that high tax bills will result in the development of agricultural land. Use value assessment programs typically base the property tax assessment solely on the value of the agricultural productivity of the land, effectively leaving the value of the development rights untaxed. Criteria used include current land use, parcel size, income/use qualification, and any prior use requirements.

Arizona, Colorado, New Mexico, Utah, and Wyoming programs are specifically designed for land that is used for agriculture, which includes grazing land, cropland, and land used for a variety of other purposes related to the production of agricultural products. Colorado, New Mexico, Utah and Wyoming extend the program to land that is used for forestry or timber production, when the production results in marketable forest products. Our analysis of existing laws demonstrates agricultural use valuation results in substantially lower taxable values for landowners in Colorado, New Mexico, and Utah. Data to make similar comparisons were not found for Arizona or Wyoming, but since the programs are designed for the same purposes it is reasonable to expect significant tax savings in those states as well.

Section 2: Use Value Taxation for Diversified Natural Resource Management on Rural Lands

Differential agricultural taxation programs in Arizona, Colorado, Utah, New Mexico and Wyoming offer extremely limited preferential assessment options for land not actively used in agriculture. Three of our five focal states allow land to continue to be classified as agricultural if it is enrolled in the Conservation Reserve Program, a federal program designed to protect and enhance agricultural productivity. Utah allows land under permanent conservation easement to be enrolled, but only if it continues in agricultural use. Colorado allows large parcels under easement to be enrolled without being used for agriculture; however, they must have been in agricultural use at the time the easement was created in order to be eligible.

Many other states provide preferential assessment programs for lands that provide wildlife habitat and other benefits. The justification is that open space also provides benefits to surrounding communities, even if the land is not actively used for agriculture. In Idaho, Montana, and Washington the programs are part of the agricultural valuation program. Oregon offers special programs for non-agricultural properties, while Texas offers one program for agricultural parcels in alternate use and another program specifically for non-agricultural properties.

In most of these states, land that qualifies as open space is valued as if it were in agricultural use, so that the "current use" valuation does not literally apply

to the actual use of the property in question; they are valued based upon their agricultural potential, as if they were actually in agricultural use. The properties receive a similar tax treatment without the expectation of any profit from approved natural resource management investments, monitoring and management activities on the land.

Section 3: Economic dimensions of changes in rural land's tax designation

A key issue for agricultural land use taxes involves rewarding legitimate agricultural operations for providing benefits to the public without creating tax loopholes for speculators or hobbyists. Good policy will align the incentives facing landowners with the broader objectives of the state. Poor policy results in an inequitable tax burden and/or the failure to meet land use and economic development objectives. The agricultural tax laws described in Section 1 detail state efforts to meet these objectives. The unintended consequences of such regulations can include:

1. Encouraging unsustainable land management practices in order to remain in compliance with narrow average carrying capacity based requirements of the law;
2. Forcing local assessors into difficult and largely subjective choices as to when operators are or are not in compliance with the intent vs the letter of the law; and
3. Foreclosing potential or emerging economic opportunities commensurate with providing the public benefits similar to agricultural land management, but not in strict compliance with the currently required practices under the state's agricultural use value legislation.

Section 2 details state efforts to address these three challenges with existing agricultural land use legislation by either:

1. Adapting their definition of agricultural use to enable a range of extensive land management activities; or
2. Creating parallel legislation to specifically address these land use alternatives with tax assessments similar to agricultural use.

We capture the portfolio of likely land use alternatives discussed in Section 2 under the umbrella term 'diversified management.' Diversified management is compared to 'stricter enforcement' with the current, or 'baseline,' agricultural use taxation legislation using our best understanding of the likely land use changes that might be observed under those conditions.

Baseline assumptions: In the absence of a change in state policy or of its enforcement, we assume that farms and ranches will not change land use for the foreseeable future despite potential intentions of the owners and opportunities to do so due to population and income growth.

Alternatives: Stricter enforcement and diversified management: We assume, on balance, farmers and ranchers currently in compliance with existing agricultural use value legislation will not be materially affected by tightened enforcement of these laws by county assessors. Farmers and ranchers who are not currently in compliance could respond to stricter enforcement in three primary ways. They could:

- Increase production/stocking rates/sales in order to come into compliance and retain agricultural use value taxation;
- Anticipate a substantial increase in their tax bill due to redesignation and therefore sell the property for (residential) development;
- Manage the property for a mix of alternative land use under 'diversified management' legislation, if there were such an option in place.

Using this information, three scenarios will be considered relative to the baseline:

1. tax policies are more strictly enforced without diversified management incentives;
2. status quo enforcement of agricultural land use tax policies, but new use tax provisions for diversified management are available;
3. both stricter enforcement and diversification are part of the policy landscape.

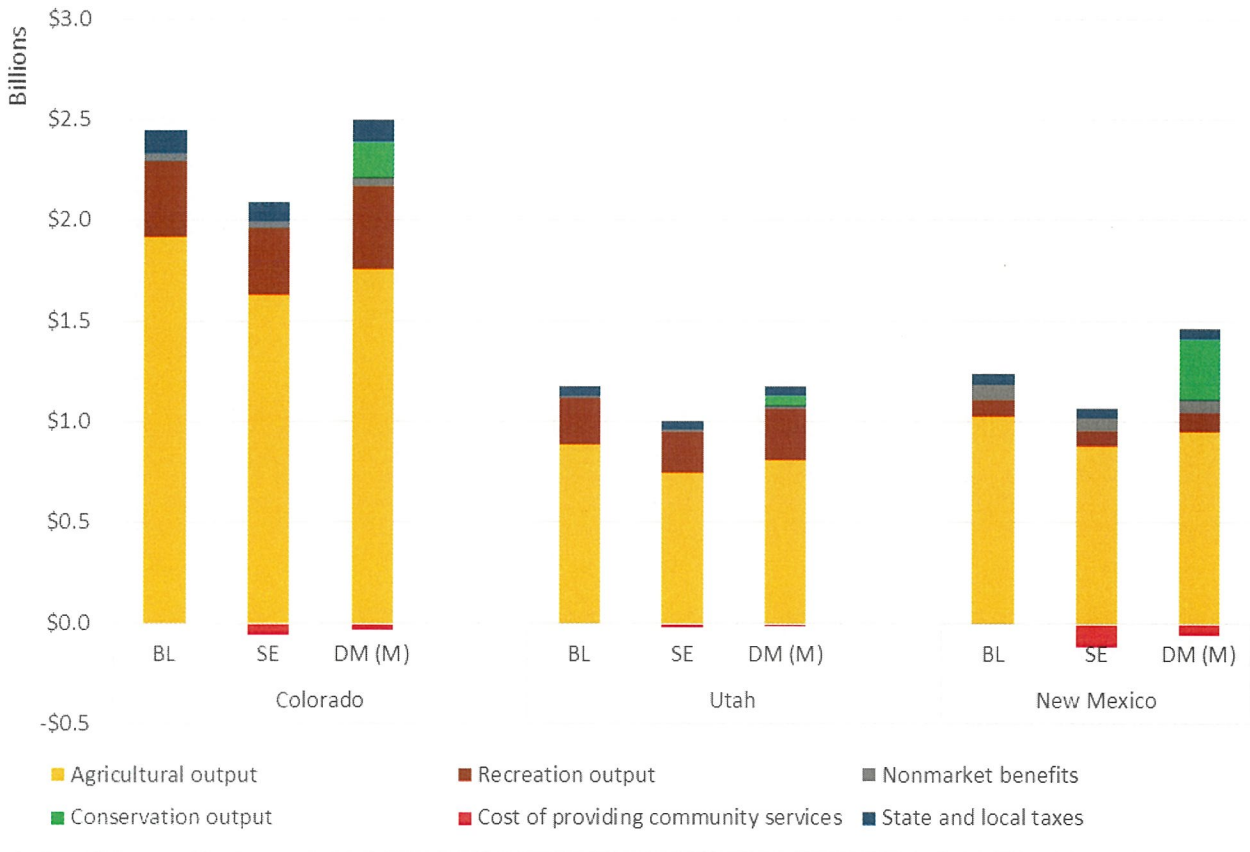
Section 4: Results of Scenario Estimates

Across all scenarios, agricultural output remains as the most important driver of economic activity in these areas. However, in general, improvements in the local economic outlook can be realized through recognition of a broader portfolio of natural resource benefits within the use value taxation legislation. In sum, in the most likely scenario, we find net improvements in the Colorado state economy of about $25 million and 250 jobs, in Utah of $150 million and 1500 jobs, and in New Mexico about a half billion dollars and 2,500 jobs per year due to a more comprehensive treatment of natural resource values from rural lands

under the tax law. Stricter enforcement of current laws is expected to reduce nonmarket natural resource values and increase the net tax burden due to conversion to residential properties. Due to market forces (e.g., the number of farms and ranches currently losing money, located in high growth and high natural amenity areas), in no case is stricter enforcement of current agricultural taxation standards expected to increase agricultural output or jobs in agriculture. In all cases diversified management constitutes a significant improvement over stricter enforcement, primarily driven by increases in investments in natural resource conservation activities and avoidance of costly conversion of open lands into residential properties (Figure 1).

In all cases except one (Utah), our estimates indicate diversified management is superior to the baseline. Without diversified management, Utah would experience a loss in public and privately captured benefits of 16% relative to stricter enforcement. In New Mexico, diversified management would result in an increase in net benefits of 47% over stricter enforcement alone, which is also a 13% increase over baseline. New Mexico also has the potential to experience the largest loss in net benefits from stricter enforcement with a 23% decrease relative to baseline. In Colorado stricter enforcement could decrease net benefits by 17% relative to baseline, while diversified management would increase total statewide benefits by 1%, a 22% improvement over the alternative. While the potential harm that stricter enforcement can impose on the economy is similar to Utah, Colorado is expected to realize a net gain from average levels of land management investment due to the number of acres available for diversified management.

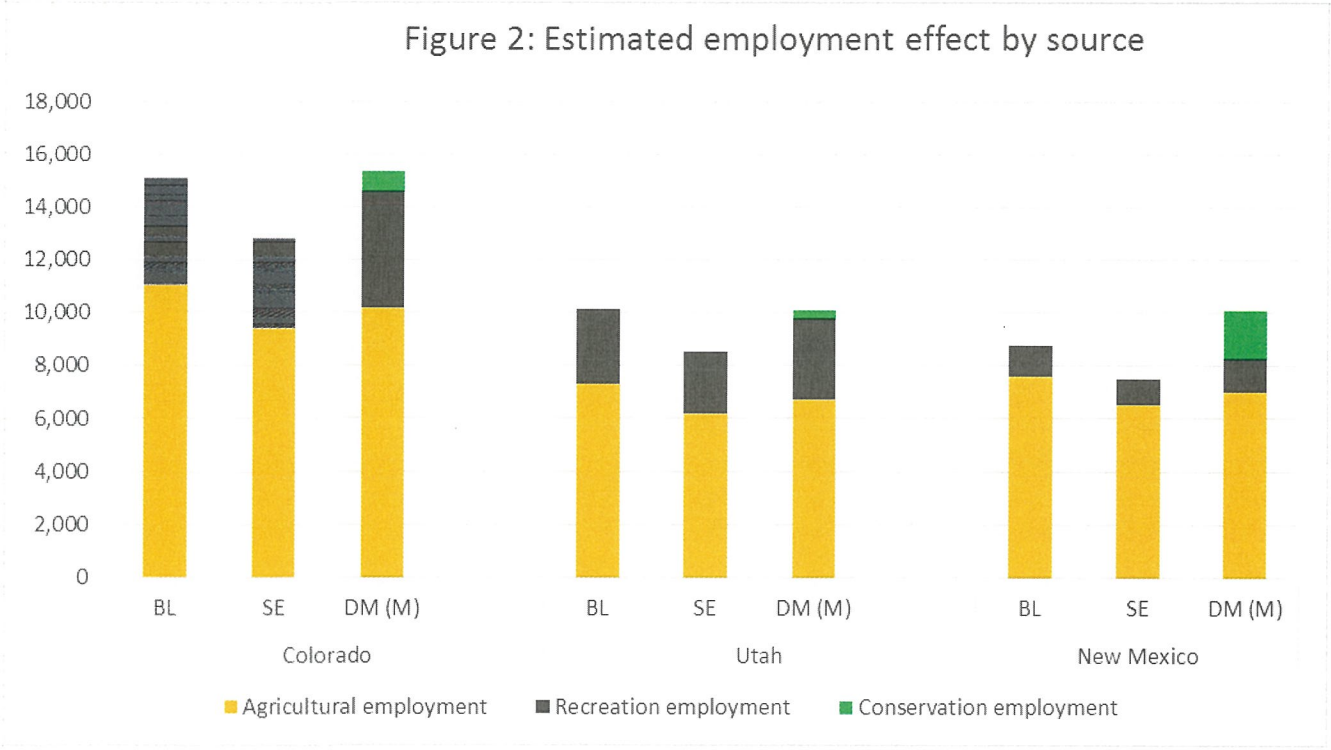
Figure 1: Estimated economic activity by source



Employment estimates also favor diversified management over stricter enforcement (Figure 2). Additionally, in all states except Utah, diversified management is estimated to support more jobs than the baseline. In Utah a loss of four jobs is projected to occur. The majority of the employment effect comes from the conservation sectors.

Overall, stricter enforcement is projected to reduce employment in Colorado, Utah and New Mexico by 15%, 16% and 14%, while medium level diversified management leads to a 2% increase, essentially no change and an 18% increase, respectively. Compared to the baseline, diversified management becomes even more favorable. Natural resource conservation accounts for between 3% and 18% of job creation in the medium level diversified management scenario and is driven mainly by the number of acres conserved; however, increasing the level of investment in natural resource conservation substantially increases the positive effect on employment.

The proportion of agricultural sector jobs ranges from 73% to 87% of the total in the baseline scenario, and falls to between 66% and 69% of the total under diversified management. However, since employment is greater overall under diversified management, this indicates a more diverse workforce that could be more resilient to economic fluctuations. Recreation related jobs are consistently between 13% and 30%, with New Mexico having the smallest portion of the three states.



Conclusions

The analysis supports the contention that allowing for diversified management in agriculture can provide substantial public benefits over stricter enforcement alone. Under the diversified management scenario, the agriculture sectors could see a smaller impact on employment and output as compared with the stricter enforcement scenario. Additionally, keeping land out of development can lead to substantial savings in the cost of providing community services to rural areas. Land that is not developed will continue to provide important nonmarket benefits. Since land will be restored or conserved under the diversified management scenario, it is reasonable to think that nonmarket benefits may increase; however, this is not taken into consideration in the numbers in this analysis.

New industry activity in land management practices for natural resource conservation or recreation will also contribute to the state economy, which further closes the gap created by the stricter enforcement of agricultural regulations. The degree to which the contribution of new activity makes up for or even adds to the economic activity of the state depends on the kinds of practices and level of investment actually engaged in by participants. At the low end of investments in natural resource conservation, the activity is likely to at least offset the shift from agriculture, especially if this occurs on marginal lands. If either stricter enforcement of diversified management lead to a difference in recreation days, the implications for the state economy could be large. In any case, this analysis supports the conclusion that diversified management is a better and more flexible outcome than stricter enforcement alone.

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All errors are unintentional and the responsibility of the authors.