
Coates' Canons Blog: Time for PUV Reform in NC?

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\$200 million. That's the estimated property tax revenue North Carolina's 100 counties defer *each year* under the state's present-use value ("PUV") property tax exclusion program for farms and other favored properties. And by "defer," I really mean "lose," because most of those deferred PUV taxes will never be collected.

The impact of PUV property on individual county budgets can be substantial. Consider Allegheny County, which in 2010-11 had a total taxable real property base of \$1.6 billion. In that same fiscal year the county deferred taxes on \$500 million of PUV property, meaning the deferred tax revenue amounted to nearly a *third* of the county's entire real property tax revenue.

Although none took the same percentage hit as did Allegheny County, nearly twenty other North Carolina counties deferred PUV property value representing at least 10% of their total real property values in 2010. Coming in the midst of the dire economic climate and plummeting revenues from other taxes, a 10% reduction in county tax revenue from real property is no small matter. And don't forget that North Carolina's municipalities also lose tax revenue on PUV property.

In light of its financial effect on local governments, it seems fair to question whether the PUV program is worth the cost. Maybe not, says national property tax expert Professor Richard England in a recent article for the well regarded Lincoln Institute of Land Policy. Prof. England concludes that major PUV reform is needed across the country. Before analyzing whether Prof. England's proposals are right for North Carolina, here is a quick primer on our state's PUV program.

North Carolina's PUV Program

Since 1973, North Carolina has provided property tax incentives through the PUV program to certain taxpayers who use their land for agriculture, horticulture, or timber production instead of development. Measured by dollars of property value avoiding taxation, the PUV program is now the second largest property tax break, exceeded only by the exemption for government property.

Property owned by a qualifying owner and used for a qualifying purpose that satisfies the applicable minimum size (e.g., 10 acres for farmland) and revenue (generally \$1,000/year) requirements is valued for tax purposes at its present use rather than at its higher true market value were it sold for development. The local property taxes on the difference between the property's present-use value and its market value are deferred.

If the owner of PUV property stops using it for a qualifying purpose or sells it to a developer, then the most recent three years of deferred taxes are subject to "rollback," meaning they are immediately due and payable. Deferred taxes that are more than three years old disappear, never to be collected. Property can remain in the PUV program indefinitely, meaning local governments can lose decades of deferred taxes from a single piece of farmland.

The PUV program is no doubt the most complicated area of North Carolina property tax law. Readers seeking a more complete picture of the program can read the authorizing statutes (GS 105-277.2 , -277.3, and -277.4) or dive into the N.C. Department of Revenue's 200-page PUV guide .

Comparison to Other PUV Programs

According to Prof. England's article, nearly every state in the nation offers some type of reduced property tax assessment to agricultural land. North Carolina's PUV program appears to be one of the broadest in that it covers a variety of uses beyond farming.

Just over half of the states apply a “rollback” penalty similar to North Carolina’s and require payment of several years of deferred taxes when a property leaves the PUV program. Another seven states levy a penalty based on a percentage of the property’s value when it stops being used for a qualifying purpose. But fifteen states have no type of payback penalty at all, meaning every penny of deferred PUV taxes become uncollectable immediately upon deferral.

Other states lack the minimum acreage and revenue requirements applied to North Carolina’s PUV properties, which has led to alleged abuse of PUV benefits by fake farmers. Case in point: a few Wisconsin taxpayers harvested weeds on their vacant residential lots and managed to obtain PUV assessments for this “agricultural” use of the properties.

Criticism of PUV Programs

Prof. England criticizes PUV programs in general for not providing sufficient incentives to keep land in agriculture, for failing to save smaller farms, and for shifting the tax burden to non-farm landowners. While I don’t disagree with his observations from a national perspective, I’m not sure they ring true in North Carolina.

First, North Carolina already applies one of the most punitive rollback penalties in existence for land that is removed from the PUV program. Few states, if any, offer a greater incentive to keep farming their land rather than selling it for development.

Second, small farms appear to be healthier in North Carolina than they are nationally. Prof. England cites national statistics that show a large decrease in the number of smaller farms and a huge increase in the share of national farm production attributable to very large farms. I don’t doubt that is true on a national level. But the trend away from small farms is not nearly as strong in North Carolina as it has been elsewhere.

According to statistics from the U.S. Department of Agriculture, smaller farms are thriving (at least relatively) in North Carolina in terms of raw numbers. From 1997 to 2007, the total number of farms in North Carolina increased from 49,406 to 52,913. Nearly all of that increase is attributable to small farms. Farms between 10 and 50 acres jumped by 5,100 during that ten-year span, while farms greater than 500 acres decreased by 550.

I don’t mean to suggest that large farms are not gaining market share in North Carolina just as they are across the country. But I do think these statistics demonstrate that the small farm is far from extinct in our state. Be it our PUV program or an increasing emphasis on eating local, small farms are popping up all over the state in growing numbers.

Third, Prof. England’s criticizes PUV programs for their social cost of shifting local governments’ tax burdens away from farmers and toward homeowners and non-agricultural businesses. Without question, this is true of North Carolina’s PUV program.

Allegheny County, for example, could have dropped its 2010 property tax rate by 10 cents, or nearly 25%, for all property owners and still produced the same amount of property tax revenue had it not been forced to defer taxes on \$500 million in PUV property.

But Prof. England’s analysis ignores the social benefits of PUV programs, namely more protection for farms, forests and conservation land. The real question is not whether the PUV program increases taxes on other taxpayers. It’s whether an increased property tax rate is worth increased open space.

Many Allegheny County taxpayers might conclude that a 25% increase in their tax rate is not worth the tradeoff. But statewide the tax rate increase caused by PUV property is far less. On average, county tax rates would drop only about 3 cents, or less than 5%, if the entire PUV program were eliminated and counties kept their revenues constant.

From a statewide perspective, a 3-cent increase in property taxes may well be worth preserving much of the state’s natural beauty. I think this is especially true for a PUV program that protects conservation land as well as farms, as does North Carolina’s. The tourism spending related to our state’s unspoiled rural and mountain vistas certainly do much to offset the lost property tax revenues, as do the economic benefits generated by thousands of thriving small farms.

Potential PUV Reform in North Carolina?

Predicting what the General Assembly will do is never easy. That said, I think it is highly unlikely that the Honorables make major changes to the PUV provisions in the near future.

North Carolina's PUV program already possesses many of the characteristics recommended by Prof. England: minimum acreage and revenue requirements, strong rollback provisions, and detailed guidance from the state Department of Revenue concerning the proper valuation of agricultural land.

More importantly, in recent years the General Assembly has demonstrated a desire to *increase* opportunities to avoid or defer local property taxes. New laws have expanded the PUV rules to cover working waterfronts and conservation land, added deferred tax programs for new housing inventory and low-income elderly homeowners, and excluded all farmland from involuntary municipal annexations. In the current political environment, it seems improbable that the state legislature would choose to limit a tax break as popular as North Carolina's PUV program.

This post was previously published on the School of Government's Community Economic Development blog.

Links

- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-277.2
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-277.3
- www.ncga.state.nc.us/gascripts/statutes/statutelookup.pl?statute=105-277.4
- www.dor.state.nc.us/publications/puv_guide.pdf
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