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Farmland Assessment Program

Tax Year 2008

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New Jersey State Legislature

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Enclosed is our report on the audit of the Farmland Assessment Program for Tax Year 2008. If you would like a personal briefing, please call me at (609) 292-3700.

A handwritten signature in black ink, appearing to read "Stephen M. Eells".

Stephen M. Eells
Assistant State Auditor
October 23, 2008

Table of Contents

	Page
Scope.....	1
Objectives	1
Methodology	2
Conclusions.....	2
Findings and Recommendations	
Application Approval Controls and Oversight	3
Oversight and Monitoring by the State and County ..	6
Program Regulations and Policy Considerations.....	7
Auditee Response	
Department of Environmental Protection	9
Department of Treasury, Division of Taxation.....	11
Auditor Comments on Division of Taxation Response.....	15

Farmland Assessment Program

Scope

We have completed an audit of the Farmland Assessment Act of 1964 (N.J.S.A. 54:4-23 et seq.) for the tax year 2008. The Department of the Treasury, Division of Taxation and the Department of Environmental Protection are responsible for monitoring compliance with different aspects of the act.

In order to qualify for farmland assessment the applicant must meet several conditions. The land must have been actively devoted to agricultural or horticultural use for the two successive years immediately preceding the tax year for which the farmland assessment is requested. Gross sales of products from the land must total at least \$500 per year for the first five acres plus \$5 per farmland acre and \$.50 per woodland acre for each acre over five. The owner must file an application annually by August 1 and must certify that the land will continue in agricultural or horticultural use to the end of the tax year for which application is made. The state constitution, Article VIII, Section I, states the land for which an assessment is requested must be at least five acres and also provides for the levy of rollback taxes for the current and prior two years if the use of the land changes.

Objectives

An objective of our audit was to determine if farmland assessments met the statutory, administrative, and constitutional requirements. Another objective was to determine if there was proper oversight by the state, the county, and the local tax assessors of the requirements. We also estimated the impact on municipal property taxes when applications were erroneously approved or participants were not in compliance with program requirements.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section I, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, and the state constitution. We interviewed Department of Environmental Protection, Department of Agriculture, and the Department of the Treasury, Division of Taxation personnel and county and municipal employees to obtain an understanding of the farmland assessment program.

A nonstatistical sampling approach was used. Our sample was designed to provide a conclusion about the farmland assessment program. As of January 2008, based on data obtained from the Division of Taxation, over 1 million acres was designated as farmland assessment. We judgmentally selected for testing the top three counties in the program which included over 379,187 acres or 37 percent of the state's total farmland assessment properties. Next we selected the municipality in each county with the greatest number of farms between 5 and 9.99 acres. Audit procedures included a review of individual applications for tax year 2008, a review of oversight procedures for compliance to the program requirements, and an estimate of the impact on municipal taxes for those properties which should not have been assessed as farmland.

Conclusions

We found numerous errors and a control weakness during our review of the application approval process that resulted in unqualified participants in the program. We also found a control environment that lacked oversight at the municipal, county, and state levels. Required on-site inspections are not being performed timely which creates the risk that ineligible participants will not be detected. These conditions reduce the amount of municipal property taxes. Based on our sampled municipalities unqualified participants received an average property tax savings of 36 times when compared to the property taxes that would have been levied on the appropriate vacant land designation. We also noted a number of policy issues that need to be reconsidered.

Application Approval Controls and Oversight

Trainning on program regulations and oversight should be enhanced.

N.J.S.A. 54:4-23.6 states that all land actively devoted to farmland/woodland use is eligible for farmland assessment provided owners meet certain qualifications. A determination must be made by the municipal tax assessor on a yearly basis through an application process. Applications must be submitted to the municipality by August 1. The approved applications are forwarded to the county tax administrator by January 1 for their review and are subsequently forwarded to the state's Division of Taxation by February 15 for data entry and reporting purposes. The municipal tax assessors, county tax administrators, the county tax boards, and the Division of Taxation all have oversight responsibility over the farmland assessment program.

The state constitution provides for levy of a rollback tax if the use of the land changes. Any land which changes from an eligible agricultural or horticultural use under the Farmland Assessment Act to some other non-farm use is subject to rollback taxes for the year in which the change takes place and for the two immediately preceding tax years.

Our review of program compliance at the three sampled municipalities noted an internal control weakness and numerous errors relating to the approval process. One municipality had a clerk approve applications instead of the tax assessor who by administrative code is required to review, approve, sign, and date the application form. We noted numerous approved application errors where insufficient land was actively devoted to farmland/woodland use. Examples of these and other errors follow.

- One property owner who paid \$93.25 in property taxes on 6.5 acres had only 1.5 acres of harvested crop actively devoted

to farmland. This property should not have qualified because the minimum five acre actively devoted to farmland requirement was not met.

- One property owner with 35.46 acres submitted an incomplete and unsigned application and paid \$601.93 in property taxes. This application should not have been approved without it being completed, signed, and reviewed.
- Six of the 81 applications reviewed were approved without the required Woodland Data Form which provides an owner's assertion that the property is actively devoted to an agricultural use and the approved Woodland Management Plan is being followed. In addition, our review of the Department of Environmental Protection's database noted that 156 approved properties statewide did not have a current Woodland Management Plan.

**On-site inspections
need to be completed to
confirm land use.**

Statutes require on-site inspection of farmland/woodland acreage at least once every three years. Our review noted that the inspections are not being completed by the tax assessors for farmland and by the Department of Environmental Protection for woodland in a timely manner. One municipality reviewed keeps a log of inspections and at the current rate it would take over 12 years to inspect all properties currently in the program. The remaining two municipalities reviewed stated they perform limited inspections but no documentation could be provided to support that they were actually performed. One of the three county tax administrators interviewed stated the county board of taxation would initiate procedures to ensure inspection requirements are met. The remaining two county tax administrators were unaware that inspections were not being performed timely. Our review of the Department of Environmental Protection noted that less than half of the required inspections are being done yearly.

In addition, the statute states the municipality may impose a fee for an on-site inspection of not more than \$25. These fees are rarely imposed. The reason for the lack of inspections is due to the limited working hours of full and part-time tax assessors. Imposition of these fees could offset the cost of performing additional inspections and serve as an inspection tracking mechanism.

Approval of ineligible applicants results in property tax losses to municipalities. The average property taxes per acre based on our sampled municipalities for farmland is \$14 per acre. When compared to the average property tax assessment for vacant land of \$507 per acre, taxes on average are 36 times less for program participants, based upon information supplied by the three municipalities reviewed and other state sources.

Recommendation

We recommend that training on regulations be provided periodically to all individuals approving applications for the farmland assessment program to enhance compliance with program requirements. In addition, the municipal tax assessors and the Department of Environmental Protection officials should perform on-site inspections of their respective land at least once every three years to ensure appropriate land use. The inspection fees would allow for a means of tracking inspections and would offset the administrative costs to municipalities.

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Oversight and Monitoring by the State and County

Proper monitoring and oversight is needed at all levels of government for the effective operation of the farmland assessment program.

There are several levels of government responsible for the effective operation of the farmland assessment program starting at the state level with the Department of the Treasury, Division of Taxation. The division has the oversight and monitoring responsibility for all application approval processes and ensuring that on-site inspections are being performed for farmland operations through its oversight of the county tax boards. The county tax boards supervise the county tax administrator, who monitors the municipal tax assessors. The last time the Division of Taxation went out to monitor the farmland assessment program was between 1983 and 1985. None of the three county tax administrators we visited reviewed the tax assessor's functions and duties as they relate to the program. The lack of oversight and monitoring at all levels has undermined the effective operation of the program.

Recommendation

We recommend that the Division of Taxation reinforce the regulations for the program and its operational expectations with the county and municipal governments. The county tax administrators should perform field visits with the municipal tax assessors in their county to determine compliance with program requirements and a formal report of the results of those field visits should be forwarded to the Division of Taxation. We further recommend that the Division of Taxation perform periodic reviews to ensure adequate monitoring at the local level is being performed.

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Program Regulations and Policy Considerations

Existing program regulations for actively devoted farmland and tax rollback need to be reviewed.

The intent of the statute is to provide financial assistance to farms through lower assessments and taxation of land. Existing regulations, formulated in 1964, require the land to be actively devoted to agricultural or horticultural use.

Our review concluded that the existing regulations on actively devoted farmland/woodland need to be defined by effort, productivity, or with current monetary values to adhere to the intent and integrity of the statute. Currently there is no clear definition of what constitutes actively devoted use of land in terms of productivity or effort. Our review noted one property owner who paid \$15.05 in property taxes with 7.26 acres of permanent pasture with only one sheep was approved by the municipal tax assessor. There is no definition of the number of required livestock per acre needed to qualify for the farmland assessment program. In addition, there is no definition for cropping quantities that would define actively devoted agricultural or horticultural production.

Gross sales of products produced from the land must total at least \$500 per year for the first five acres plus \$5.00 per farmland acre and \$.50 per woodland acre for each acre over five. These amounts have not changed since 1964. Consideration should be given to changing the dollar amounts to reflect current sale values.

Our review also noted that the existing tax rollback provisions are significantly less than states with a similar program. The state constitution provides that if land is changed from agricultural/horticultural to non-farmland use then the difference in taxes based on the non-farmland use would be recovered for the current and prior two years. Other states use a longer rollback period as a deterrent for land speculation.

Recommendation

We recommend that the state oversight organizations review and advocate changes to the regulations/policy defining actively devoted farmland/woodland. In addition, consideration should be given to modifying the gross sales requirements and the length of the tax rollback recovery period.

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October 22, 2008

Mr. Thomas R. Meseroll
Assistant State Auditor
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125 South Warren Street
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Dear Mr. Meseroll,

Thank you for the opportunity to review and respond to the draft audit report regarding the Department of Environmental Protection, Farmland Assessment Program, which covers the tax year 2008.

We would like to address several of the report's conclusions and recommendations for which the Department has primary responsibility. Therefore, on behalf of the Department's Office of Natural and Historic Resources, Division of Parks and Forestry, we hereby offer information on current program status, as well as on-going and planned corrective actions.

Application Approval Controls and Oversight

The audit made note of the number of approved properties statewide listed in the Department's database that did not have a current Woodland Management Plan as required by statute (approximately 156 of 4,300 properties). The State Forest Service is actively reviewing activities at the 156 properties, identifying those landowners who have dropped out of the program and working with landowners who are updating their woodland management plans (sometimes local tax assessors approve woodland assessment if the landowner can show they are working on updating their plan). For those landowners who are not actively updating their plans, by the end of this tax year, December 2008, the forestry staff will notify, in writing, the local tax assessor that the landowner no longer qualifies under the Woodland Assessment program.

In addition, the State Forest Service is in the process of updating its Woodland Assessment database to provide an additional level of oversight and greater program coordination. Currently, each of the three regional offices maintains a separate farmland database. These separate databases are now being consolidated into a central Trenton database.

The Department of Environmental Protection's State Forest Service is required to inspect all woodland-assessed properties (approximately 220,000 acres) once every three years. As a result of an OLS audit in 2004, which found that the frequency of farmland inspections were not being performed as required by the timetable in the statute (approximately 1,450 inspections/year), the Department agreed to increase inspections to the best of its ability recognizing staffing constraints. While a similar deficiency in the frequency of inspection is identified in the 2008 audit, currently, approximately 57% of the annual inspection quota is achieved (approximately 825 inspections/year). This is a significant increase over the 2004 level of approximately 325 inspections annually.

Program Regulation and Policy Considerations

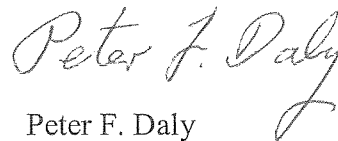
OLS recommends changing the dollar amounts for gross sales of products produced from the land to reflect current sale values. For woodland properties, there is concern that raising the gross sale values could result in non-sustainable management practices of a landowner's forest resources. Any increase considered in gross sale of products required to qualify for the Farmland Assessment Program should not result in the landowner over cutting the forest. Consideration should be given to the longer rotational age needed to produce a forest product compared to an annual row crop.

The Department supports providing additional consideration to landowners who enhance forest ecosystems by actively managing their properties for habitat improvements that result in society benefits.

In closing, the Department, as always, accepts the recommendations, and will continue to monitor the implementation of corrective actions for the particular phases of the Farmland Assessment Program which fall under the purview of our State Forest Service.

In addition, I would like to personally commend both the field audit staff for their professionalism and thoroughness, and the Management and Technical Review Staff for the attentive oversight and guidance during this engagement.

Sincerely,



Peter F. Daly
Controller, Management & Budget

C: Lisa P. Jackson, Commissioner
Ved P. Chaudhary, Assistant Commissioner
Amy Cradic, Assistant Commissioner
James Barresi, Assistant Director



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October 21, 2008

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Re: Audit – Farmland Assessment Program

Dear Mr. Meseroll:

The following comments respond to the conclusions and recommendations included in the Audit Report of the Farmland Assessment Program (Program) issued by your office on October 8, 2008. We thank you for the opportunity to provide insight into the administration of the Program.

Division of Taxation Monitoring of Farmland Program

The Audit Report notes the responsibilities of the Division of Taxation (sometimes "Division") in monitoring compliance with the Farmland Assessment Act (Act). However the Report does not recognize the extensive interaction that the Division of Taxation has cultivated with various State and local agencies and the agricultural and environmental communities in exercising its oversight responsibilities.

While some provisions of the Act specifically assign certain responsibilities to the Division of Taxation and to the DEP, the provisions direct that those responsibilities are to be carried out in consultation with the Department of Agriculture. The Audit does not reflect the actual working relationship among Taxation, DEP and the Department of Agriculture in assisting both farm owner applicants and municipal assessors in understanding and complying with Program prerequisites. The Local Property Tax Policy Unit within the Division of Taxation regularly consults with the Department of Agriculture regarding legitimate agricultural/horticultural practices, growing seasons, activity levels etc. and with DEP, Forestry on woodlands issues.

N.J.S.A. 54:4-23.20 also specifically calls for the creation of the State Farmland Evaluation Advisory Committee (FEAC) which designates the Secretary of Agriculture and the Dean of the College of Agriculture Rutgers University as well as the Director of the Division of Taxation as members. The FEAC Committee annually determines and publishes the range of values for each of the several classifications of land in agricultural and horticultural use in the various areas of the State based upon productivity capabilities.

<http://www.state.nj.us/treasury/taxation/>

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Additionally, the Division of Taxation chairs a Farmland Committee that meets regularly throughout the year. The Committee is comprised of individuals from State, County and Municipal governments and the agricultural and environmental communities. The NJ Farm Bureau, the NJ Tree Farm Bureau, Rutgers' Agricultural School-Cook College, NJ Forestry Service DEP, NJ Department of Agriculture, NJ Division of Taxation, the Association of Municipal Assessors of NJ (AMANJ), the NJ Association of County Tax Boards (NJACTB) and the NJ Department of Community Affairs are among the permanent members. Matters of policy and practice are discussed, formulated and standardized. These members get the word out to their respective communities and promote uniform treatment and compliance which is reinforced with trainings offered by the Division of Taxation in forums such as Assessor Conferences, County Tax Board Conferences, League of Municipalities, Approved Continuing Education courses. The Division also routinely accepts speaking requests to explain the Farmland Assessment Program.

Audit Methodology

The auditors employed a non-statistical methodology in each of three test counties, and selected the municipality in each with the greatest number of farms between 5 and 9.99 acres. The Auditors found numerous examples of insufficient agricultural land actively devoted, i.e., where the FA-1 application showed less than the requisite minimum 5 acres. However, parcels under the same ownership are often reported on separate FA-1 forms and meet the eligibility criteria only when viewed together as contiguous parcels. See Rutgers Report "Evaluating Changes in the Eligibility Provisions for Farmland Assessment in New Jersey" 2008 at page 48 # (2) which identifies 6,474 FA-1 forms for 160,189 acres falling into this category. It appears the audit findings may not have considered the use of separate FA-1 forms and their effects on satisfying Program eligibility criteria.

Moreover, none of the anecdotal error examples presented in the audit report was verifiable or addressable. Because property identifiers such as block and lot numbers were not provided, the Division was unable to provide an alternate explanation or refutation of the reported scenarios.

The audit report concluded that unqualified participants received an average property tax savings of 36 times when compared to the property taxes that would have been levied on the appropriate vacant land designation. The audit report does not show the underlying calculations. If buildable vacant land values were used as opposed to non-buildable land values, this would inflate the amount of taxes that would be paid.

Assessors' Responsibilities

The report commented on the failure of municipal assessors to perform farmland inspections every three years and suggested that the imposition of a statutory fee of \$25 per inspection would offset the cost of performing additional inspections.

It is worthy of recognition when considering this suggestion that of New Jersey's 566 municipal taxing districts, 421 or 74% employ part-time assessors. Only 145 taxing districts employ full-time assessors.

Farmland Assessment is only one of at least 65 separate and specific duties performed by an assessor over the course of the tax year. In addition to Farmland Assessment, some other duties of the assessor include: Annual Property Valuation, Determination of Deductions, Exemptions and Abatements, Added and Omitted

Assessments, Defense of Appeals, Compliance Plans and Reassessment/Revaluation Programs, COAH Non-Residential Development Fee Determinations.

The time required to conduct actual physical inspections is likely not available given the broad scope of assessor responsibilities, and the \$25 fee per inspection would not offset the costs of performing the inspections. Consider the following example:

An assessor annually receives 515 FA-1 forms. Given the three year inspection cycle, the assessor would conduct 171 inspections per year. Assuming the assessor inspected 15 farms per day, it would take the assessor 11 days to complete the inspections. Assume 230 work days per year. A part-time assessor working two days a week in a municipality would devote 11% (11 days divided by 100 work days) of his/her work time to farmland inspections, a significant percentage of an assessor's time. This time devoted to farmland inspections would draw the assessor away from duties that directly generate local property tax revenues. It is respectfully submitted the \$4,275 received from inspections (171 x \$25) clearly would not be a cost effective offset.

Further, it is important not to lose sight of the fact that the assessor is entitled to rely upon the FA-1 form as completed by the applicant. The Farmland Assessment Form is like any other tax return where the information provided by the taxpayer is assumed to be accurate as reported. In Wishnick v. Upper Freehold Township, 15 N.J. Tax 597 (1996) the Tax Court concluded that assessors can rely on the FA-1 form when making Farmland Assessment eligibility determinations. The Court held that the plaintiffs' farmland assessment claims are to be tested solely by whether the subject property qualifies for farmland assessment according to the specific agricultural use claimed on plaintiffs' application for farmland qualification. The Court concluded that the holding was necessary to avoid burdening municipalities with unreasonable inspection responsibilities and to avoid thwarting the Legislature's plan for controlling the granting of farmland assessments. 15 N.J. Tax at 601.

Recommendations for Statutory Change

The audit report suggested that the Division of Taxation advocate for statutory changes to the definition of actively devoted farmland and; to the gross sales requirement of the Act; and to the length of tax rollback recovery period.

As an initial comment, it is not within the purview of the Division to advocate for legislative change. That is a matter within the jurisdiction of the Legislature. If requested by the Treasurer, the Division would provide assistance, as appropriate to the Legislature to fully understand the mechanics of the Program.

Secondly, the recommendations suggest a less than full appreciation of the statutory, regulatory and judicial framework from which the Program has matured. The Farmland Assessment Act is clear in defining the tests to be satisfied to establish eligibility for a farmland assessment. See N.J.S.A. 54:4-23.1 et seq. The Division has adopted a chapter of regulations that provide guidance on all aspects of the Program. See N.J.A.C. 18:15 -1.1 et seq. Additionally, a comprehensive body of judicial case law – no fewer than 50 cases – has developed over the last 25 years interpreting the Act and opining upon its proper implementation.

As it relates to the suggestions to change the gross sales and rollback criteria of the Act, an October 8, 2008 report from the Food Policy Institute, Rutgers University is

noteworthy. In Evaluating Changes in the Eligibility Provisions for Farmland Assessment in New Jersey, the authors concluded:

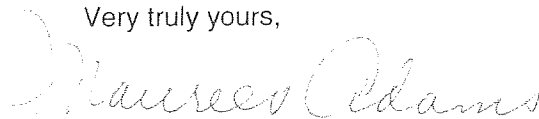
- Raising the minimum revenue requirement to \$750 would result in 18,103 acres of land being rendered ineligible for farmland assessment and the estimated loss of \$629,000 in agricultural industry revenue (p.134).
- Raising the minimum revenue requirement to \$1,000 would result in 47,378 acres of land being rendered ineligible for farmland assessment and the estimated loss of \$2.07 million in agricultural industry revenue (p. 134).
- Raising the minimum revenue requirement to \$2,500 would result in 149,631 acres of land being rendered ineligible for farmland assessment and the estimated loss of \$10.75 million in agricultural industry revenue (p. 135).
- Raising the minimum revenue requirement to \$10,000 would result in 398,093 acres of land being rendered ineligible for farmland assessment and the estimated loss of \$51.15 million in agricultural industry revenue (p.135).
- Maintaining the minimum revenue requirement at \$500, but raising the additional revenue requirement for agricultural and forested land to \$50 per acre and \$5.00 per acre, respectively, would result in 50,670 acres of land being rendered ineligible for farmland assessment and the estimated loss of \$716,000 in agricultural industry revenue (p. 136).

Similar conclusions relating to an increase in the minimum acreage requirement and the rollback period appear in Recommendations of the Farmland Assessment Review Committee for Arthur R. Brown Jr., March 2001 and Farmland Assessment in New Jersey: Effects of Revisions in Eligibility Requirements on Land Use, Open Space and Municipal Finance by the Department of Agricultural, Food and Resource Economics, Rutgers University, May 1999.

The examples highlight the complexity of the issues that surface when contemplating changes to the Farmland Assessment Program. The Division of Taxation cautions that a thorough evaluation of potential consequences must be undertaken prior to proposing changes to the Program.

Thank you for the opportunity to comment on the Audit Report.

Very truly yours,



Maureen Adams
Director
Division of Taxation

Auditor Comments on Division of Taxation's Response

The following comments on the Division of Taxation's response regarding Audit Methodology are made to clarify the audit work performed in reaching our conclusions.

- The audit did consider the use of separate FA-1 applications in the same or an adjacent municipality when determining whether the minimum five acre requirement was met.
- With regards to providing division personnel the specifics of our anecdotal error examples, they informed us to discuss these with the county tax officials. We reviewed our exceptions with the tax administrators and they concurred with our findings.
- As indicated in the report the value of the ineligible land was obtained from the municipal tax assessor.

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