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Preferential Taxation

of Farmland:

The Ohio Experience

E. T. Shaudys

Introduction:

Basic in our system of government is the right of the individual to own private property. The determination of how our land is to be used was left to the discretion of the economic marketplace. Land during our nation's early years was so abundant that an unconstrained market was used and provided an acceptable allocation device. Until recently, the market allocation system has served our needs with little need for governmental constraint. In order to serve the needs of a developing society we are finding it necessary to increase governmental controls over the individual's use of real property. It has been recognized that without constraint, some owners could reap unacceptable benefits at the expense of others in the society.

The realization that our highly productive agriculture land is finite and that the domestic and export demand for agricultural products is increasing are causative policy modification forces. Our national land use programs are important, however a dominant land use control capability is vested in state authority. In states like Ohio, urban-related pressures have caused us to develop many, non market, state and local government land use controls. The taxation of land is used as one of the most compelling land use controls. A review of the land use control system operative in Ohio can help to understand why a preferential taxation of farmland was enacted.

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Background:

Ohio as a "home rule" state, has vested a superior power in local governmental units. "Home rule" enabled local authorities to develop school, welfare, police and fire protection, health, and other programs in accord with the conceived need and support. In the Ohio scenario, the township and school districts were dominant for many governance activities with the county serving general administration functions.

"Equity" treatment of all citizens is another cornerstone of governance. Taxation equity requires properties having the same monetary value, regardless of ownership or location, be taxed so the imposition of one mill generates exactly the same revenue. "Home rule" permits individual taxing districts to control the millage rate and the allocation of the revenues generated. However, the Ohio constitution provides that the same valuation procedures be used for all parcels of property. Thus, different classes of property owners and property in different locations were constitutionally prescribed to receive "equitable" tax treatment.

A third tenet is "tax neutrality" or the concept that the imposed tax should not influence the use of property. The tax, in and of itself, should not force a change nor be the use determinant. Market forces other than the tax should influence and guide the owners in determining property use.

The Ohio legislature has recognized the economic contribution and influential political power base of the agricultural sector. Although Ohio is characterized as a state with several large urban-industrial centers, the agricultural sector has a strong political power.

The market allocation of land historically has yielded an acceptable result. Land has been released from agriculture to other uses according to economic demand with few political constraints. Recently "noneconomic" controls of land use have been gaining political support. The longer

range land use control is conceived by many in our society, as not being adequately provided by the existing economic market allocation mechanisms. The society is both dependent on land and is the ultimate land owner. The individual in our system of governance is granted certain specified rights by the society.

Control of the System:

The Ohio constitution mandates the control power of the public land use rights, including taxation, police power, eminent domain, and escheat. This same constitution mandates "home rule" for land use control authority at several levels of governance. The constitutional powers are strengthened through public or governmental spending. Spending power is often used by one level of government to cause other levels of authority to participate in land use control programs in the desired manner.

Each county auditor in Ohio is selected as the chief property assessing officer, and has responsibility for determining the taxable property values. The elected county auditors may or may not have expertise in property appraisal. Further, they are reminded with each election that they serve at the pleasure of their constituents. Changes in technology, demand for land, and political control influence the individual auditor's judgment. Considerable variation in program execution is found to exist from county to county. Other county officers (engineer, treasurer, and commissioners) are involved in the management of real property taxation. The public service programs, including schools, police, welfare, roads and drainage authorities, represent user demands for tax revenue. Coordination of the system is achieved through a tax duplicate review, at the state level, by the Department of Tax Equalization. Another component of the system designed to provide taxpayer equity treatment is a sexennial real estate reappraisal. Each sixth year, on a county rotation basis, each parcel of real property is revalued for tax purposes. Nevertheless equity in real property taxation, has been elusive. This is summarized in a Legislative Service Commission report as follows: "It has been found, upon the examination of Ohio property tax laws over the past century, administrative, statutory and judicial, that the Ohio property taxpayer, in the absence of fraud or conspiracy, has generally enjoyed little legal protection from unlawful taxation resulting from discriminatory assessment. Tax assessments generally have not met the constitutional text of equity and uniformity. Throughout real property tax history, Ohio's

county auditors have ignored the statutory assessment standards and the General Assembly (Legislature) and the county (judiciary) and other state agencies have been unwilling or unable to compel general compliance" (Legislative Service Commission Information Bulletin, 1979-1).

Goals and Results of Taxation:

One of the primary purposes of real property taxation is the extraction of revenue for the support of schools and other public programs. Other tax provisions have been approved by local electorates to provide particular benefits, and to influence certain uses of real property. For example, the homestead exemption is a welfare program to assist older property owners, who may be less able to share the tax burden. In contrast, a special forest tax assessment program, enacted in 1925, provides for a 50% market value tax reduction if the owner follows approved forest management practices. The Current Agriculture Use Value and the water and sewage rotary fund are recent special purpose modifications. The Current Agricultural Use Value taxation encourages qualified owners to continue a farm usage of land. Tax relief has also been utilized to attract "desirable" industry, for historic preservation, to benefit nonprofit organizations, to encourage labor employment and other similar "beneficial" activities. These programs are varied, each having been identified as providing some "unique" contribution to the society.

Each of these tax related programs does, in some manner, modify the operation of the economic or commercial real estate market. Land use policy is the composite of these constraints, benefits and expectations, as interpreted by the market community of buyers and sellers.

Antecedents of Current Agricultural Use Value in Ohio:

Several factors contributed to the need for farmland tax adjustment. Some were mandated by the legislature and public authority and others were administratively institutionalized over time. The auditors developed important taxation modifications by applying different percentages of market value according to the class or property. For example, commercial property could be assessed at 40%, residential at 35%, and agricultural property at 30% of market value in the same county. Although a standardized sexennial reappraisal was required to determine comparable market valuation, these different assessment ratios resulted in a different tax treatments.

Example

Computations of Real Property Tax in Ohio

	\$100,000 Appraised at 100% of market
	× 35% Assessment ratio (percent of market value for tax assessment)
	\$ 35,000 Assessed taxable value
	× .042 Voted millage rate
	\$ 1,470 Annual tax bill (payable in two installments)

Using an assessment ratio of 30% would reduce the tax bill to \$1260 and a ratio of 40% would increase the bill to \$1680.

The auditors had developed an institutionalized support for this procedure although it was not supported by the Ohio constitution. These assessment modifications gained credibility at all levels of government and have been used by some auditors for several decades.

Disparity in the property tax was increased over time and finally caused certain taxpayers to seek relief through the legal process. Challenges of the auditor's institutionalized handling of tax assessment procedures gained judicial support and have culminated in a series of recent Ohio Supreme Court decisions. The institutionalized assessment procedures were found unconstitutional and the court prescribed the procedures that must be followed. The Ohio Supreme Court determined that equity treatment required that *each parcel of property in the state be appraised as of the same date, that all parcels be appraised at 100% of market value and be assessed at 35% of market value*. This taxable value must be multiplied times the voted millage rate and the tax bills imposed accordingly.

Much Ohio agricultural real estate has urban proximity and had been universally assessed at below market value. Farmland has been further benefitted by applying conservative assessment ratios. The Ohio Supreme Court ruling would result in a substantial increase in farmland tax obligations. The increase would be most chronic in areas having a substantial non-farm value influence. Increases in farmland tax burdens in excess of 100% would be common. It was recognized that such adjustments would impose a hardship on the individual farm owners and could be detrimental to the general "well-being." Ohio is characterized as having many large urban concentrations such as Cleveland, Cincinnati, Columbus, Dayton, Toledo, Lima, Akron, Canton, Springfield and Youngstown. All of Ohio's farmland suffers some value influence from the 11 million people distributed from these large urban complexes. The combination of farmland inflation and urban related

demand imposed major upward price pressures.

The Supreme Court ruling would force farm owners to carry a much larger part of the total tax burden than had been historically required. When the Supreme Court ruled that the Board of Tax Appeals (The State Tax Equalization Authority at that time) must implement the decision, or be held in contempt, the Board countered that it lacked budget and responsibility to execute the decision as rendered. Subsequent legislative actions delayed implementation and concerned agricultural people took the problem to the electorate in the form of a campaign for a differential farmland tax treatment. Several Ohio farm organizations joined in proposing a constitutional amendment to permit qualified agricultural land to receive preferential treatment. It had been tested in the judiciary that the existing law did not allow "differential taxation", thus a constitutional amendment was required. A campaign for a constitutional amendment was structured to gain support from the urban electorate. The importance of agriculture and the damage from continued farmland loss was made known. The campaign gained endorsement of the ten largest city mayors, the four major farm organizations, the majority and minority leaders of the House and the Senate, and finally the Governor. This campaign culminated in the general election of 1973, with a 73 percent favorable plurality, the largest ever achieved for an Ohio constitutional amendment.

With this strong political support base, the legislature passed enabling legislation for a preferential agricultural tax treatment, and prescribed initiation for the 1974 tax year. The Board of Tax Appeals was empowered to develop the rules and to cause the auditors to execute the program. The Cooperative Extension Service developed educational programs for benefit of County auditors and administrators, contract tax assessors, agricultural service units, and interested individuals.

Preferential farmland tax treatment was developed to preserve private control of the "land use" decision at an acceptable cost to society. Through this system, farmland owners would be taxed at the "typical" agricultural use following the capitalized income approach and not be taxed at the higher market value based on development and speculation. The farmland owner would have a tax obligation consistent with the typical farming income. Conversion of land out of farming could be made by the owner without having to petition a governmental authority. The control of land use remained the owner's decision with the conversion cost being a modest tax recoupment penalty.

The System:

Basic to effectively implementing this change in farmland taxation was administrative simplicity at modest cost. The taxation system must be easily understood by county administrators and by farm and urban taxpayers. Tax appraisal costs were a major concern of the county auditors. The Ohio sexennial reappraisal had been completed at a cost of \$4 to \$6 per parcel. These goals of low cost and administrative understanding must be satisfied if the procedure was to be accepted and supported.

Taxation of land according to use value requires that the productivity of the farm be known. Components of the existing system that were functioning acceptably could continue to be used. It was also recognized that market forces imposing upward price pressure were related to land rather than buildings. Buildings and improvements were being acceptably assessed using the market value approach. Thus, it was determined that buildings would continue to be appraised using the market value method as in the past. However land would be assessed by capitalizing the farm income.

Soil productivity and Soil Conservation Service land use capability classes can be used to measure the productivity of land with typical management. The soil productivity index rates yield potential and land use capability measures the hazards associated with use. Fifty-two of Ohio's 88 counties have been completely soil inventoried, 20 counties are in progress, and many farms in the remaining 16 counties have been mapped. This information is readily available, is well understood, and can be used to provide a valuation system based on soil productivity.

Soil Identification:

Over 350 soil types are found in Ohio. However, these soil types have been grouped into eight major regions and into 63 soil management groups. Soils in each of the 63 individual soil management groups have essentially the same crop yield potential under typical management and with similar inputs. Cropping patterns are varied according to the land capability class. A high percentage of intertilled crops can be grown on the Class I and II soils. Conversely, more of the soil protecting crops such as small grains and meadows should be grown on the III and IV class soils.¹ The soil management group and land capability class make it possible to derive typical yields for crop, pasture and woodland uses. Selected prices must be applied to the crop yield to ascertain the gross income. Sources of farm commodity price information are available in USDA publications for commodities and pro-

duction inputs, interest rates, labor wage rates, etc.² In order to minimize year-to-year price variations, a 5-year moving average weighted for the major field crops typically produced was used.

Some land currently in pasture or woods has crop potential. These areas may require additional capital investment for clearing and drainage to convert to cropland. The land value for such areas is determined by deducting the conversion cost required from the crop use value. The typical pasture or woodland net income is used for land areas having a resultant value below conversion cost.

In order to utilize farmland for production, certain input costs are incurred. Annual production cost information for major field crops has been developed and published by the Cooperative Extension Service and the Ohio Agricultural Research and Development Center.³ The net income per acre is capitalized using a rate derived by using the "mortgage equity" method. The following data sets are employed in developing the capitalization rate: 1) Farm real estate mortgage terms, percent of debt, and interest rate offered by the Federal Land Bank; 2) market return on comparable investor equity; and 3) the appreciation of agricultural land. Annually a study of the "market" is made to obtain these data for developing the capitalization rate.

The net income developed for each soil management group is divided by the derived capitalization rate to yield the per acre appraised value. Values for land capability Classes I through IV are usually established for a cropland use. Classes V through VII are valued for pasture and woodland. The result is reduced to a table that identifies the 63 major soil management groups on one axis and the land use capability indices on the other axis (see appendix). Within each soil cell, the value of cropland, pastureland, and woodland is given. The value of cropland that can be converted from pasture or woodland is shown only if greater than the conversion cost. When conversion results in a zero or negative value, the woodland or pasture net income is capitalized. The tabled information is generated annually by the Department of Tax Equalization, for use by the 88 Ohio county auditors.⁴ Each cell provides the actual appraised value for one acre. The auditor must only identify the acres in a respective soil management group to determine the appraised taxable value of the farmland.

Farmland owners must make an application, pay an initial \$10 application fee and an annual \$2 fee, as of a specified date, in order to qualify for CAUV appraisal. The acreage in each soil management

group by existing use is made a part of this application. Owner assistance for completing the application is provided by auditor, the Soil Conservation Service, and county agricultural agents for identifying and measuring the soil acreages as required. The acreage of land in each of the soil management categories is provided on the application which is multiplied by the tabled values to ascertain the appraised value. This value is added to the farm building value obtained using the market technique to determine the tax value of the farm. In several counties, this system has been computerized and the annual adjustment is made by inputting the current data in the program.

To qualify for the Current Agricultural Use Value tax treatment, the taxpayer must own 30 or more acres used exclusively for commercial agricultural production. For a tract less than 30 acres, an average annual agricultural gross sale of at least \$2500 must be earned for a three-year period.

The county auditor is responsible for certifying each application. For example, recreational land uses such as riding horses do not qualify. However, if horses were kept for breeding purposes and the offspring sold and grossed \$2500 annually, the property could be qualified for CAUV tax treatment. The garden store producing plants was another concern. It was determined that the land used for the production of plants for sale could be qualified, however the land used for the store operation could not.

The auditor (or staff), is required to physically view the parcel, after receiving an application and to approve or reject the application.

For each qualified parcel both the Market and Current Agricultural Use Value assessment information are maintained on the tax appraisal card. The difference between the market and CAUV values is the basis for the recoupment penalty for land converted out of an agricultural use. Such conversion can be made at any time but a conversion penalty must be paid by the owner at time of conversion. It is important to note that both the taxes assessed and recoupment are a lien against the land and not the owner as such. The recoupment is the difference in the tax that would have been paid if assessed and taxed at the market value and tax that was actually paid during the past four years. The farmland owner has no other obligation or conversion penalty. Additionally, parcels can be split with the fraction remaining in a qualified agricultural use continuing with the CAUV treatment if the 30 acre or \$2500 annual gross requirement can be satisfied. Land converted would be eligible for the recoupment and in the future could be appraised using the market value technique.

Results:

The objective was that farmland be preserved and that the farmland owner continue to be the dominant land use decision maker. The major costs of the program are the transference of tax incidence to non-farm taxpayers plus the additional cost of administration.

A reduction in taxes has the same effect as an increase in income. Many grain farmers must gross four to five times the realized net income. Reducing taxes by \$5 per acre could be equivalent to increasing corn production by a 10 to 12 bushel per acre without incurring additional production cost. This has a positive income benefit and provides endorsement for a continuing farm use for the land.

Historically, Ohio's auditors had achieved an informal preferential taxation treatment for farmland. As a result of the legal objection, mandamus suits and court actions, this treatment was found unconstitutional.

The auditors had afforded differential taxation in a manner that did not encourage recourse as a taxpayer can legally object only if his tax is higher than prescribed. The fact that another owner is taxed lower than mandated does not provide grounds for objection. However, this treatment did violate the concept of equity, and when finally tested in the Ohio Supreme Court, was found to be unconstitutional. However, mitigating market forces were operative and caused society to become concerned about the resultant impact on land use. Thus, the electorate did provide the needed support for a major change in the way farmland could be assessed for taxation.

Non-farm demands for land have influenced selling prices above current or anticipated earnings. Farmer buyers in strong equity positions were found among the bidders, but often bid against developers and speculators. The "market sale" was questioned as the best indicator of value for taxation assessment if societal goals included farmer ownership of farmland and the continuance of a farming use of land. In this case, the Ohio "body politic" reduced the tax responsibility of farmland owners in order to encourage a continued farm use and farmer ownership of land.

Ohio has experienced a conversion of over one million acres of productive land area out of agriculture into urban, transportation, and manufacturing uses during the past two decades. More important, some of the most productive agricultural land has suffered conversion. The limited access highway system frequently has been related to this conversion. Interstate 75 from Toledo to Cincinnati, I-70 from east to west, I-71 from Cleveland through Columbus to Cincinnati, and I-77 from

Cleveland to Marietta illustrate this point. Along each of these primary transportation arteries, utilities, industrial parks, residential and recreational uses have encroached on prime agricultural lands. As this urban encroachment upon agricultural land has evolved, sizeable acreages had been acquired by non-farmland owners and were removed from an agricultural use.

It was the ambition of the Current Agricultural Use Value taxation sponsors that conversion of land out of farming uses could be tempered. Preservation of open space and encouragement of farmers ownership of land did receive generally strong public support.

The Market and Current Agricultural Use Value tax appraisals yield comparable land values in the predominately agricultural counties. Conversely, farms proximal to urban pressure display differentials. Counties dependent on farmland tax revenues would generate about the same revenues from either the market value or the Current Agricultural Use Value assessment. Farmland owners in the metropolitan counties may be the most benefited. These counties are most able to accommodate the reduction in farm tax revenue as farm real estate taxes are a small part of the total.

For the 1978 tax year, over 3.3 million acres of the 17 million acres in farms (almost 1 in 5) in Ohio were qualified for the Current Agricultural Use Value assessment. Many farmland owners have not been fully affected by the CAUV provisions as of the 1978 tax billing, as the sexennial reappraisal had not been completed. Only two-thirds of the counties have had the sexennial reappraisal since inception of the Current Agricultural Use Value assessment provisions. In the reappraised counties a large number of farm owners have qualified for

the Current Agricultural Use Value taxation valuation. Conversely, in counties that have not been reappraised, few farm owners have applied for the Current Agricultural Use Value appraisal.

Differences in individual auditor treatment continue. However, with the clarity of the legislation, and the state enforcement capabilities afforded, the auditors and County Boards of Revision are obligated to perform a more equitable appraisal and assessment than ever before. At the present time, farmland taxed under the Current Agriculture Use Value provision has relieved the owner of approximately \$9 of tax per acre during the 1978 tax year (a total of \$30 million annually). It is anticipated that with completion of the reappraisal cycle as much as two-thirds of the total farmland acreage may be taxed under the CAUV provision.

Certain weaknesses are recognized. Location differences are reflected only as associated with soil groups. Commodity market location advantages, size and historic management practices are not considered.

The Future:

The debate on public control over private ownership of land use rights continues. The Current Agricultural Use Value taxation is only one element in this debate. Other societally-held property controls are being developed and will change the individual ownership use rights of property.

In Ohio other bases for support for education and public services are being considered. The Ohio farmland preferential tax system has proven workable, is politically supported, is acceptable to farmland owners, and has shifted the tax burden incidence in such a way that the electorate is satisfied.

Preferential Taxation of Farmland: The Ohio Experience

**Worksheet for Developing
Current Agricultural Use Valuation of Land**

Land Use and Soil Type	Soil Management Group	Land Capability Class	Acres	*Price Per Acre	Indicated Value
CROPLAND					
Clermont	S-6	III	60	410	24,600
Crosby	C-2	II	40	780	31,200
Brookston	C-4	II	40	960	38,400
Rossmoyne	S-5	II	20	640	12,800
PERMANENT PASTURE					
Clermont	S-6	II	20	410	8,200
Crosby	C-2	II	10	780	7,800
WOODLOT					
Brookston	C-4	III	8	60	480
HOUSELOT					
—	—	—	2	1,200	480
ROADS					
TOTAL			200		125,880

* Use CAUV Tables

Current Agricultural Use Value of Land	125,880	
Present Value of Buildings (Market)	28,000	
Total CAUV Appraisal of Farm		153,880
Farm Appraisal Land Value (Market)	282,000	
Farm Appraisal Building Value (Market)	28,000	
Total Appraisal Value of Farm (Market)		<u>300,000</u>
DIFFERENCE		146,120

NOTE: It would be advisable for the landowner in this situation to file an application for CAUV taxation since the CAUV is smaller than the fair market value of the farm.

DEPARTMENT OF TAX EQUALIZATION, STATE OF OHIO
1978 Current Agricultural Use Value of Land Tables
IMPORTANT NOTE: These tables for use only
in counties appraised or updated in tax year 1978.

Table IV
Soil Region Soil Developed on Illinoian Glacial Till of Southwestern Ohio

Soil Management Group	Land Use	LAND CAPABILITY CLASS								
		I	II	III	IV	V	VI	VII	VIII	
S1	Cropland			470	250	—	—	—	—	—
	Pasture	*	*	*	*	200	120	50	50	50
	Woodland			70	60	50	50	50	50	50
S2	Cropland			450	230	—	—	—	—	—
	Pasture	*	*	*	*	190	110	50	50	50
	Woodland			60	60	50	50	50	50	50
S3	Cropland	1140	800	500	260	—	—	—	—	—
	Pasture	*	*	*	*	220	120	50	50	50
	Woodland	740	400	100	60	50	50	50	50	50
S4	Cropland	1120	790	490	260	—	—	—	—	—
	Pasture	*	*	*	*	210	120	50	50	50
	Woodland	320	60	90	60	50	50	50	50	50
S5	Cropland		720	450	240	—	—	—	—	—
	Pasture	*	*	*	*	190	110	50	50	50
	Woodland		320	60	60	50	50	50	50	50
S6	Cropland			450	240	—	—	—	—	—
	Pasture	*	*	*	*	190	110	50	50	50
	Woodland			60	60	50	50	50	50	50
S7	Cropland	830	580	370	190	—	—	—	—	—
	Pasture	*	*	*	*	160	90	50	50	50
	Woodland	430	180	60	60	50	50	50	50	50

* Same as Cropland Less Cost of Conversion Base Class Bold

DEPARTMENT OF TAX EQUALIZATION, STATE OF OHIO
1979 Current Agricultural Use Value of Land Tables
IMPORTANT NOTE: These tables for use only
in counties appraised or updated in tax year 1979.

Table IV
Soil Region Soil Developed on Illinoian Glacial Till of Southwestern Ohio

Soil Management Group	Land Use	LAND CAPABILITY CLASS								
		I	II	III	IV	V	VI	VII	VIII	
S1	Cropland			440	230	—	—	—	—	—
	Pasture	*		*	*	190	110	50	50	50
	Woodland			60	60	50	50	50	50	50
S2	Cropland			420	220	—	—	—	—	—
	Pasture	*		*	*	180	110	50	50	50
	Woodland			60	60	50	50	50	50	50
S3	Cropland	2050	740	470	250	—	—	—	—	—
	Pasture	*	*	*	*	200	120	50	50	50
	Woodland	625	315	60	60	50	50	50	50	50
S4	Cropland	990	700	440	230	—	—	—	—	—
	Pasture	*	*	*	*	190	110	50	50	50
	Woodland	105	60	60	60	50	50	50	50	50
S5	Cropland		640	410	220	—	—	—	—	—
	Pasture	*	*	*	*	170	100	50	50	50
	Woodland		210	60	60	50	50	50	50	50
S6	Cropland			410	220	—	—	—	—	—
	Pasture	*	*	*	*	180	100	50	50	50
	Woodland			60	60	50	50	50	50	50

Base Class Bold

*Same as Cropland Less Cost of Conversion.

Footnotes

¹ Percent of crops by class:

Land Capability Class	corn	soybeans	wheat	meadow
I	40	40	10	10
II	32	32	18	18
III	20.5	20.5	26	33
IV	18	0	22	60
V-VIII	pasture or woodland			

² Agricultural Prices, United States Department of Agriculture Economic Statistical and Cooperative Service, Washington, D.C.

³ Ohio Crop Enterprise Budgets, 1979. Grains-Forage. Department of Agricultural Economics and Rural Sociology, The Ohio State University.

⁴ A current Agricultural Use Value Advisory Committee is appointed by the Commissioner of the Department of Tax Equalization to represent agricultural interest groups for review of conversion costs, changes in technology and other factors that may influence the discovery of taxable value.

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