

Overview of Farm Leases

National Agricultural Law Center
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By Cari B. Rincker, Esq.



My Background

- Grew up on a beef cattle farm in Central Illinois
- Education
 - A.S. in Agriculture from Lake Land College
 - B.S. in Animal Science from Texas A & M
 - M.S. in Ruminant (Beef Cattle) Nutrition from University of Illinois
 - J.D. from Pace Law School (2007)



My Background

- Chair of the American Bar Association, General Practice, Solo & Small Firm Division's Agriculture Law Committee
- My food and agriculture client base
 - Farmers to ranchers
 - Small to mid-size agri-business
 - Food entrepreneurs



Overview

- Active v. Passive Income
- Types of Farm Leases
- Lease Provisions
- Price/Rent Negotiation



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Rental Leases: Active v. Passive Income



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Active v. Passive Income

- **Social Security**
 - You must claim a certain number of credits under the social security system before receiving social security
 - A farmer client may be worried about reaching this threshold as he/she nears retirement



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Active v. Passive Income

• **“Self-Employed”**

- A person is self-employed if they carry on a trade or business (such a farming/ranching) in good faith to make a profit
- Self-employed persons are subject to self-employment tax and receive social security credits



“Farmer’s Tax Guide” IRS Publication 225



Active v. Passive Income

• Are landlords “self-employed” for self-employment tax purposes?

- The general rule about leases is that “income and deductions from rentals and from personal property leased with real estate are not included in determining self-employment earnings.”
- However, income from farm/ranch leases **will be included** if the landlord **materially participates** in the production or management of agriculture production.
 - Thus, the issue is whether the rental income is active or passive income.



“Farmer’s Tax Guide” IRS Publication 225



Active v. Passive Income

• So what is “**material participation?**”

- Landlord must meet **1 of 4 different tests**
- Keep these tests in mind when drafting the farm/ranch lease



“Farmer’s Tax Guide” IRS Publication 225



What is "Material Participation?"

Test 1: Landlord does three (3) of the four (4)



Pay at least 50% of the direct costs for producing crop or livestock



Furnish at least 50% of the tools, equipment and livestock used in the production activities



Advise/consult the tenant in the farming/ranching activity



Inspect the production activities periodically

"Farmer's Tax Guide" IRS Publication 225



What is "Material Participation?"

Test 2: Regularly and frequently takes part in **important decision-making** and management of the farm/ranch directly affecting the success of the operation



"Farmer's Tax Guide" IRS Publication 225



What is "Material Participation?"

Test 3: Works **100 Hours** plus LL is directly connected to agriculture production over a period of **5 weeks or more**



"Farmer's Tax Guide" IRS Publication 225



What is "Material Participation?"

Test 4: Looking at the big picture, the LL is **materially and significantly** involved in the production of farm commodities



"Farmer's Tax Guide" IRS Publication 225

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Types of Farm Leases



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3 Basic Types of Farm Leases



Cash Rent



Crop-Share



Hybrid/Flexible

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Cash-Rent Lease

- This is where the tenant usually pays a **fixed dollar amount** in rent (either on a per acre or whole farm basis).
 - May be modified slightly depending on **crop yield** (i.e., increase in good years and decrease in bad years).



Cash-Rent Lease

Advantages for the Landlord

- Less managerial labor
- Less administrative headache
- Predictable cash rent income
- Less concern over division of expenses and marketing

Disadvantages for the Landlord

- LL isn't "actively engaged in farming" and income is not subject to the self-employment tax
- LL may have difficulty getting paid
- More difficult to determine fair cash rent amount acceptable to both LL and T
- Cannot receive FSA direct or counter-cyclical payments



Cash-Rent Lease

Advantages for the Tenant

- Full decision-making authority/ autonomy
- Doesn't have to divide profits from a good harvest
- Less capital tied up in the land
- Doesn't have to share direct or counter-cyclical payments with landlord

Disadvantages for the Tenant

- Increased risk with commodity price fluctuations
- If LL terminates lease, T may have difficulty finding a new land to lease
- Increased risk with short-term leases with improvements to land



Crop Share Leases

- In these arrangements, **the landlord will share input costs** (including but not limited to seed, fertilizer, fuel) while the tenant provides all of the labor and remaining input costs.
 - Once harvested, proceeds will be divided according to the agreement (normally ranging from 25/75 to 50/50).
 - In this scenario, the farmers both share the risk.



Crop-Share Lease

Advantages for Landlords

- LL likely “actively engaged in farming” if participating in management decisions & subject to self-employment taxes
- Tenant must share FSA direct or counter-cyclical payments with landlord

Disadvantages for Landlords

- Variable income



Crop-Share Leases

Advantages for Tenants

- Management oftentimes shared between an experienced LL and inexperienced T (mentor relationship?)
- Fewer operating monies are tied up in the land
- Sharing risk of low yield and prices with the LL

Disadvantages for Tenants

- T loses autonomy because the LL is involved in management decisions
- Sharing profits from good crop yields
- Sharing direct and counter-cyclical payments with Landlord



Livestock-Share Leases

Most view livestock-share leases as a type of crop-share lease.



The landlord may own a portion of the livestock animals and typically shares the burden of input costs, such as feed.



Hybrid / Flexible Leases

- In this type of lease, **the landlord will receive a minimum fixed rent payment** while sharing in some of the profits, losses, and decision-making.



- a/k/a Variable Cash Rent Agreements
- Based on crop prices / yields or inputs



Hybrid/Flexible Leases

Advantages for Landlords

- Depending on how the lease is drafted, LL may share in management decision-making to be considered "actively engaged in farming"

Disadvantages for Landlords

- Somewhat variable income



Hybrid/Flexible Leases

Advantages for Tenants

- Reduced financial risk
- Reduced labor

Disadvantages for Tenants

- Still lack full autonomy as LL may be involved in decision-making



The Farm Lease



General Lease Provisions

- Parties
 - Make sure both the Landlord/Tenant or Lessor/Lessee is clearly identified
 - Use legal names (think about DBA's)
- Purpose
 - Should list the purpose of the lease
 - Corn production
 - Direct farm marketing
 - Agri-tourism



General Lease Provisions

- Property Description
 - Address
 - Legal Description
 - FSA farm number
 - Possible Exhibits
 - Map of property
 - List of buildings/structures
 - List of farm machinery/vehicles



General Lease Provisions

Lease Term

- Should be clearly stated
 - If silent then year-to-year will be inferred
- Check the law in your state
 - In some states, longer leases more than X number of years must be recorded
 - Some states have a maximum length of farm lease
- Usually, longer leases are better for tenants



General Lease Provisions

- Renewal Terms
 - Include provisions allowing for any renewal of the lease
 - Reasonable time period
 - Notice of Intent to Renew
 - Should include any agreed-upon compensation for any fall fieldwork completion (if applicable) upon the event of a nonrenewal



General Lease Provisions

Payment Terms Is this cash rent, crop-share or hybrid/flexible?

Rent amount and instructions?

Who is responsible for property taxes, insurance and utilities?

Penalties, interest and security for late payment



General Lease Provisions

- **Insurance**
 - Is the landlord or tenant required to have insurance?
 - If so, what type?
 - Farmowners' Comprehensive Liability Policy
 - Commercial Insurance
 - Products Liability Insurance
 - What limits?
 - 1 mil. per occurrence?



Think about the type of tenant operation



General Lease Provisions

- **Reimbursement of Expenses** - In some crop-share or hybrid leases, the tenant may seek reimbursement for crop nutrients (e.g., lime), the cost of improvements or other operational expenses.



General Lease Provisions

Duties and Prohibitions	Desired/prohibited farming practices
	Maintenance of farm buildings/fences (including temporary structures)
	Controlling noxious weeds/ brush
	Soil conservation practices
	Making improvements (e.g., buildings, renewable energy)
	Requirement to reseed plowed field
	Use of fertilizer



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General Provisions

- **Duties & Prohibitions**
 - Keep in mind the “**Right-to-Farm**” law in your state
 - In New York, for example, an agriculture producer cannot be sued for a nuisance claim if they are performing a “sound agricultural practice” within an agriculture district
 - Thus, what part of the farm is in an agriculture district?
 - Are there specific activities that the LL would like to proscribe?
 - Some leases define Good Management Practices (“GMP’s”)
 - Duty to comply with farm animal welfare law at the federal, state and local level?

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General Lease Provisions

- **Duties & Prohibitions**
 - Prohibition against agri-tourism (hayrides, petting zoos), on-farm direct marketing (e.g., farmstands or pick-your-own), or on-farm poultry slaughter?



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General Lease Provisions

• **Duties & Prohibitions**

– It is especially important to think about decision-making and management in crop-share or hybrid lease situations

- Active v. Passive Income



General Lease Provisions

• **Duties & Prohibitions**

– Will the tenant have any reporting requirements?

- What must be reported and when?
- Examples
 - Grid sampling
 - Yield monitor data
 - Weigh wagon results
 - Test plot results
 - Soil tests



General Lease Provisions

• **Fertilizer:** In most farm leases, the issue of fertilizer should be addressed somehow.

- Most crop leases stipulate that the same amounts of fertilizer and lime be applied annually.
- Some leases state that soil tests should be performed to ensure for proper fertility levels (e.g., flight map/farm plan map with matching soil tests in each field).



General Lease Provisions

• **Environmental Law**

– Have tenant promise to comply with federal, state and local environmental laws

- What are the potential issues?
- Duty to minimize certain activities that may cause environmental conservation?

– Soil conservation provisions?
 – Hazardous material provisions?



General Lease Provisions

• **USDA Farm Service Agency ("FSA") Farm Program Payments**

– If applicable to the LL or T, federal farm programs should be addressed

– Examples

- Conservation Reserve Program ("CRP") Payments,
- Conservation Security Program ("CSP") Payments,
- Direct and Counter Cyclical Program Payments ("DCP")

– Lease should describe who will be receiving the federal farm payments and how the payments will be shared

- Cash rent vs. Crop-Share



General Lease Provisions

- **Default:** Your lease may include a list of actions that count as defaults in the terms of the lease, specifying whether part or all of the listed defaults can be cured or waived by the other party.



General Lease Provisions

- **Notice:** Include notice provisions, to specify how and when to give notice of default, notice of intent to terminate the lease, or any other notice needed to make the terms of the lease work.



General Lease Provisions

- **Ability to Assign or Sublease:** The lease should state whether (or under what conditions) the tenant can assign or sublease its obligation to another farmer.



General Lease Provisions

- **Landlord's Right** to enter the property to:
 - Make a reasonable inspection
 - Make repairs and/or installations
 - Show the premises to prospective buyers
 - Collect rent
 - Deliver a notice to terminate the tenancy
- **Security Interest** for Landlord
 - Crops/livestock



General Lease Provisions

- **Termination**
 - The lease should include procedures for terminating the lease, either voluntarily or involuntarily (for example, in case of a default).
 - Requirements for the Notice of Termination
 - Will the lease terminate upon death of either party?
 - Make sure the procedures comply with the law in your state
 - It should also note any reimbursement or crop nutrients, lime and/or completed fieldwork upon the termination of the lease.
 - These provisions should also include the tenant's right if the property is transferred or condemned during the lease period and reimbursement provisions for a crop still in the ground when the lease is terminated.



Miscellaneous Provisions

Confidentiality	Severability Clause	Alternative Dispute Resolution
Choice of Forum	Choice of Law	Indemnification
No Joint Venture/Partnership	Intellectual Property	Signature Block/ Notary Block



Miscellaneous Provisions

- **Alternative Dispute Resolution**
 - Exception for Emergencies- Going to Court
 - Negotiation Stage
 - Non-binding Mediation
 - Agriculture mediation program?
 - Non-binding vs. Binding Arbitration
 - Rules of the American Arbitration Association?
 - Location of arbitration



Miscellaneous Provisions

- Intellectual Property
 - Will the tenant be doing business under the landlord’s name?
 - Prefer “licenses” to intellectual property such as trademarks and copyrights (whether registered or not) in a separate document



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Rent/Price Negotiation

- Each side should look at the fair market values in their areas
 - Tenants can be criticized for having more “informational power” when negotiating rental price
 - Landlords tend to be more “out of touch” with market trends
 - If representing the landlord, have a candid discussion with client re rental price
 - Most landlords don’t ask for rent increases when they could
 - Should rent in the lease be indexed for inflation?



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Rent/Price Negotiation

- Factors involved in rent determination
 - Cash value of the farm
 - Comparable farm leases in the area
 - Production contribution the farm can make to the tenant’s operation
 - Is the land productive?
 - Are the improvements helpful to the operation?
 - Is there adequate water?
 - Has the property been adequately maintained?



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Other Types of Farm Leases

- Farmstead Lease/ Residential Lease
- Farm Equipment/ Machinery Lease
- Labor-Share Leases
- Manure Application Agreement
- Livestock Leases
 - Bull/stallion/ram/boar leases
 - Livestock-share leases
 - Grazing leases



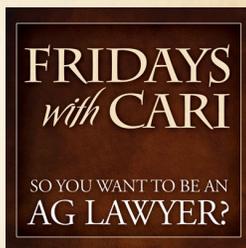
Meeting With Clients

- Farm clients prefer flat fees vs. billable hour
 - Can be done effectively for contracts like farm/ranch leases
 - See Survey Results - <http://www.slideshare.net/rinckerlaw/statgies-for-developing-and-retaining-ag-clients>
- Client Questionnaire
- Developing Checklists



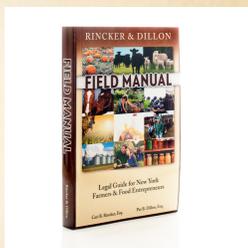
Questions on Being an Agriculture Lawyer

- Fridays with Cari Skype Calls
 - First Friday of the month at 2pm ET
 - RSVP to cari@rinckerlaw.com
 - No charge



Oh, P.S. – I Just Wrote a Book

Cari B. Rincker & Patrick B. Dillon, "Field Manual: Legal Guide for New York Farmers & Food Entrepreneurs" (2013)



Available at <http://www.amazon.com/Field-Manual-Legal-Farmers-Entrepreneurs/dp/1484965191>

www.newyorkagriculturelaw.com



Please Stay in Touch

- Send Me Snail Mail: 535 Fifth Avenue, 4th Floor, New York, NY 10017
- Call Me: (212) 427-2049 (office)
- Email Me: cari@rinckerlaw.com
- Visit My Website: www.rinckerlaw.com
- Read My Food, Farm & Family Law Blog: www.rinckerlaw.com/blog
- Tweet Me: @CariRincker @RinckerLaw
- Facebook Me: www.facebook.com/rinckerlaw
- Link to Me: <http://www.linkedin.com/in/caririncker>
- Skype Me: Cari.Rincker