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INSIDE

- Conservation Reserve Program long-term policy

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Conservation easements for agricultural landowners

A tax deduction is available for property contributed to a charitable organization. In recent years, the idea of preserving agricultural land by donating a permanent easement over the property to a charitable organization while maintaining the right to farm or ranch the land has gained momentum. The protection of farm and ranch land, timberland, and open space are common objectives of donors of conservation easements. This is especially true where the land is under residential or commercial development pressure or where local planning regulations identify such activities as valuable to the community.

The qualification for a tax deduction depends on the satisfaction of numerous technical rules.¹ Other rules limit the deductible amount. Also, the IRS has recently placed conservation easements on their "dirty dozen" list of fraudulent tax schemes.² Clearly, agricultural landowners need to proceed with caution when donating conservation easements and follow the rules closely.

Deductibility of donated conservation easements

In general, a charitable deduction is available for the fair market value of property donated to a charity. Donation of a conservation easement is an exception to the rule that the donor must part with the entire interest in the property to be able to claim a charitable deduction.³

What is a "qualified conservation contribution"?

Three tests must be satisfied for the contribution to be qualified:

1. The contribution must be of a qualified real property interest,⁴ be perpetual,⁵ and restrict the donor's land use of the property;⁶
2. The contribution must be made to a qualified organization;⁷ and
3. The contribution must be exclusively for a conservation purpose.⁸

The exclusivity requirement may be a difficult test to satisfy. While the desire to obtain tax benefits does not negate the "donative intent" necessary for a charitable deduction, the donor cannot reserve uses in the easement document that are inconsistent with the conservation purposes advanced by the easement. While this does not prohibit the grantor from retaining any rights to use the property, any retained rights must be consistent with the conservation purposes of the easement.

Example: Mary donated a scenic easement over a 900-acre woodland and pasture in the Flint Hills. All of the property is visible from a nearby state park. Mary reserved the

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More on handling CSP payments

On June 24, 2005, the Federal Register (at page 36,557) carried a Notice of Determination by the Secretary of Agriculture that payments under the Conservation Security Program¹, under criteria specified in the USDA regulations,² are "...primarily for the purpose of conserving soil and water resources or protecting and restoring the environment."³ The Secretary is charged with making such a determination in order for the payments to be eligible for the cost share exclusion available under federal income tax law.⁴ The Secretary of the Treasury is obligated to make a determination that the payments under the program do not increase "...substantially the annual income derived from the property."⁵

The Secretary of Agriculture, in the June 24, 2005 notice, proceeded to state that "...this determination permits recipients to exclude from gross income, for Federal income tax purposes, all or part of the existing practice, new practice, and enhancement activity payments under the extent allowed by the Internal Revenue Service."⁶ However, as discussed in a November 18, 2005 *Agricultural Law Digest* article,⁷ the exclusion provision is limited to "capital improvements."⁸ Cost-share payments for the adoption of land-based structural practices should be eligible for the exclusion for income if the practice is a capital improvement.⁹ Cost-share payments for the adoption

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right to divide the property into 10 parcels with one single-family dwelling allowed on each parcel. Applicable zoning laws specify a minimum 40-acre lot size.

Result: IRS would likely deny a deduction on the basis that the reserved development potential would destroy the scenic view and would be inconsistent with the conservation purposes of the easement. If, however, a portion of the 900 acres was not visible from the state park, and the conservation easement required that Mary's reserved development rights be exercised only on that portion of the property, the IRS might allow a deduction.

The Regulations also provide that a deduction will not be allowed if the contribution would accomplish a conservation purpose, but would permit destruction of other significant conservation interests.

Example: Fred Farmer donated an easement on his farm to support a government flood control program, but reserved the right to farm the property. The easement did not prohibit Fred's use of pesticides.

Result: IRS could challenge the deduction because the easement did not prohibit a use that could impair other significant

conservation interests (likely to be the case if there is a naturally occurring ecosystem on Fred's property).

But, if a non-conservation use is reserved that would be necessary to advance other conservation purposes, the reservation of the rights to such uses in the easement will not preclude deductibility.

Example: Tex granted a conservation easement over his ranch to preserve the use of the land for ranching pursuant to a "clearly delineated governmental policy."

Tex could allow the destruction of some significant conservation interests, such as elimination of sage brush from grazing areas, if necessary to advance the conservation purpose of ranching.

The following are allowable conservation purposes:

1. The preservation of land areas for outdoor recreation or education of the general public (this type of easement requires public access to the property);

2. The preservation of open space (including farmland and forest land) for either the scenic enjoyment of the general public, or pursuant to a clearly delineated governmental conservation policy. In either case, the conservation contribution must yield a significant public benefit;

3. The preservation of an historically important land area or a certified historic structure;

4. Easements donated for the protection of a significant natural habitat of wildlife or fish, and;

5. Easements donated for preservation of historically important land areas or historic structures (which require visual access by the public)

For many agricultural landowners, open space easements are the most popular.⁹

Rules for open space easements

An open space easement must preserve the scenic enjoyment of the public (or be donated for a clearly delineated governmental conservation policy). The donor must show that development of the land would result either in an impairment of the scenic character of the landscape or would interfere with a scenic view that can be enjoyed from a public place. Scenic enjoyment is determined by a facts-and-circumstances test that accounts for regional differences in topography, geology, biology and cultural and economic conditions.¹⁰

At a minimum, visual access to or across the property is required. While the entire property need not be visible to the public, if only a small portion of the property is visible to the public, the public benefit from the donation may not be enough for the donation to qualify for a deduction. So, just what is a "significant public benefit"? The Regulations contain a non-exclusive list of eleven factors that may be considered.¹¹ In accordance with those factors, the donation of a perpetual easement that preserves farmland pursuant to a state pro-

gram for flood prevention and control meets the test. So would an easement that preserves a unique natural land formation for the enjoyment of the general public, and an easement that preserves a woodland along a public roadway pursuant to a governmental program to preserve the appearance of the area by maintaining the scenic view from the highway. Conversely, no deduction will be allowed for an open space easement if the terms of the easement reserve a right of future development that will interfere with the essential scenic quality of the land.¹²

What is the amount of the tax deduction?

Valuation of the easement. An easement donation is valued at fair market value, determined either by sales of comparable easements or by taking the difference between the fair market value of the property before the easement is granted and the fair market value of the encumbered property after the easement is granted.

Example: Juanita donates an easement on land that is valued at \$2,000,000 before the donation. The value of the land drops to \$1,500,000 after the easement is donated due to the restrictions on future use imposed by the easement. The value of the easement is, therefore, \$500,000.

Under the before-and-after approach, the fair market value of the property before the contribution must take into account not only the current use of the property, but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would be developed. The valuation must also take into account the effect of any zoning and conservation or historic preservation laws that already restrict the property's potential highest and best use.

If the donor has a reasonable expectation of receiving financial or economic benefits greater than those to be obtained by the general public as a result of the donation, no deduction is allowed. Likewise, if development is permitted on the donated property, the fair market value of the property after the donation must account for the effect of development. But, land subject to a conservation easement may be freely sold, donated, passed on to heirs and transferred in every normal fashion without negating the tax benefits of the donated easement, so long as the land remains subject to the restrictions of the easement.

Calculating the deductible amount. Generally, deductions for charitable donations to public charities are limited to 50 percent of the donor's "contribution base" annually.¹³ That is an individual's adjusted gross income without regard to the amount of the contribution and without regard to any "net operating loss carryback." However, a gift of "long-term capital gain" property (property that the taxpayer has held for more

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Conservation easements/Cont. from p. 2 than one year) is subject to a limitation of 30 percent of the donor's contribution base, unless an election is made to use the 50 percent test. If the election is made, the deduction is limited to the amount of the donor's basis in the donated easement.¹⁴

Example: In 2005, Sally donates an easement worth \$500,000. She has owned the property that is subject to this easement donation for five years, and is subject to the 30 percent limitation. Sally's annual income is \$100,000. Thus, she may only deduct \$30,000 of the easement gift (30% x \$100,000) annually, even though the value of the easement is \$500,000. However, she may "carry forward" the unused portion of her deduction for five years subject to the same percentage limitation in those years.¹⁵

Because a conservation easement is only a partial interest in property, the donor must allocate his or her basis in the property between the property as a whole and the easement.¹⁶ Likewise, upon donation of a conservation easement, the donor must reduce basis in the easement property to reflect the proportion of the unrestricted fair market value of the land at the date of the donation represented by the value of the easement. This has the effect of limiting the tax benefit of the original donation.¹⁷

Example: Ralph donates a conservation easement over 500 acres of his 2,500-acre ranch. Ralph's basis in the entire ranch is \$1,000 per acre, but has a current fair market value of \$2,000 per acre. The easement is worth \$700,000, reducing the value of the 500 acres to \$300,000. The easement also enhances the value of the unrestricted portion of the ranch by 10 percent, from \$4,000,000 to \$4,400,000. Therefore, the net deduction that Ralph is entitled to is \$300,000 (\$700,000 - \$400,000). Only the portion of the ranch subject to the conservation easement receives a basis adjustment. The adjustment does not take into account the enhancement to the unrestricted part of the ranch, even though that enhancement reduced Ralph's deduction (it did not reduce the value of the easement, it merely offset that value for deduction purposes). The percentage of the unrestricted value of the 500 acres represented by the easement was 70 percent (((\$1,000,000 - \$300,000) / \$1,000,000). Therefore, the adjusted basis for the portion of the ranch subject to the easement will be \$300 per acre [\$1,000 - (70% x \$1,000)].

If Ralph is able to use the entire \$300,000 deduction and the income sheltered by that deduction is taxed at 35%, the initial tax benefit will be \$105,000 (35 percent x \$300,000). The additional gain on that portion of the ranch subject to the easement when Ralph sells the ranch will be \$700 greater per acre because of the basis adjustment required to reflect the easement donation (\$1,000 - \$300). Thus, Ralph will pay long-term capital gains tax on an additional \$350,000 (\$700 x 500 acres) of value, or

\$52,500 (\$350,000 x 15%). This increased capital gains tax must be subtracted from the initial benefit derived from the easement donation to determine Ralph's net tax benefit (\$105,000 - \$52,500 = \$52,500).

Recipient of the easement must be a "qualified organization"

Even if the donor can meet all of the tax rules necessary to receive a deduction for the donation of a permanent conservation easement, the donee must be a "qualified organization." To be qualified to receive a conservation easement, the donee must be a governmental unit, or one of several types of public charities.¹⁸ The donee must also be committed to protect the conservation purposes of the donation,¹⁹ and must have the resources to enforce the restrictions.²⁰ If the donee fails to ensure that donated easements continue to serve an exempt purpose, or if the donee subordinates the interests of the public to the interests of the donor, the donee's tax exemption may be challenged.

Conclusion

While conservation easements can be a useful tool for the preservation of key agricultural land and play a vital role in the preservation of open spaces, the qualification and tax rules must be followed closely. Currently, IRS has over 240 donors under audit because they have claimed an open space easement deduction, and is considering auditing another 100 donors. An open space easement donation will be examined closely to ensure that there is public access (visual or otherwise), that the property is not ordinary in nature and that a conservation purpose is being served. Valuations must be backed with data sufficient to support the claimed deduction. IRS also has numerous charities under examination.²¹ Promoters of conservation easements are also being examined.

Good legal and tax counsel is a must.

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¹ While the terms of conservation easements are entirely up to the landowner and the donee to negotiate, the Internal Revenue Code establishes requirements that must be met for the donation to be deductible.

² I.R. 2005-19 (news release announcing "dirty dozen" tax scams, including contributions of historic façade easements). IRS believes that many conservation easements are overvalued.

³ I.R.C. §170(f)(3)(B)(iii).

⁴ The easement must qualify under state law as a qualified real property interest. If the easement fails to qualify under state law, the result is a binding restriction on land use with no associated tax benefits.

⁵ For an easement gift to be in perpetuity, the easement deed cannot include any reversionary right in the donor, or the donor's successors in title, or any other provision that would allow the donor to unilaterally recover any or all of

the rights conveyed by the easement. The requirement of perpetuity limits easement deductibility on lands where the possibility of mineral extraction exists. The Regulations pose substantial difficulties for prospective easement donors when the right to access and extract minerals has been severed from the surface.

⁶ I.R.C. §170(h)(2)(C).

⁷ I.R.C. §170(h)(3).

⁸ I.R.C. §170(h)(4).

⁹ Unfortunately, much of the IRS scrutiny is focused on open space easements.

¹⁰ The factors for consideration include: (1) the compatibility of the land use with other land in the vicinity; (2) the degree of contrast and variety produced by the visual scene; (3) the openness of the land; (4) the degree to which the land use maintains the scale and character of the urban landscape; and (5) the consistency of the view with state programs and landscape inventory. Treas. Reg. §170A-14(d)(4)(ii).

¹¹ The major ones are: (1) the uniqueness of the land; (2) the intensity of current or foreseeable development; (3) the natural or historic character of the area; (4) the opportunity for the general public to use the property or appreciate its scenic values; and (5) the importance of the property in maintaining a local regional landscape or resource that attracts tourism or commerce to the area.

¹² Many "open space" easements reserve the right to some additional residential development of the land subject to the easement. The Regulations do not impose a blanket prohibition of such reservations, but they do provide a basis for the disallowance of a deduction if *too much* development is reserved. How much is too much depends upon the conservation purposes of the easement and the nature of the easement property.

¹³ I.R.C. §170(b)(1)(A).

¹⁴ Treas. Reg. §1.170A-8(d)(2). As a planning strategy, the election makes sense when the value of the easement does not exceed the donor's basis in the easement.

¹⁵ The carryforward period is for five years after the year of the donation or until the amount of the deduction has been used up, whichever occurs first. Thus, in the example, Sally would only be able to deduct \$180,000 of the \$500,000 easement donation assuming her annual income remains at \$100,000 throughout the carryforward period. As such, Sally may want to consider phasing the donation in over a period of years.

¹⁶ I.R.C. §170(e)(2).

¹⁷ However, because the gain on sale would be taxed at long-term capital gain rates, and the income sheltered by the deduction is taxed at ordinary income rates, the basis adjustment should not be a significant disincentive to most easement donations.

¹⁸ The Regulations do not require that an organization be organized or operated exclusively for one or more of the conservation purposes. Therefore, organizations whose purposes include the advancement of agriculture, ranching, or timbering practices and providing assistance to landowners engaged in those practices, for example, could qualify. In other words, easements may be held by organizations that are not purely environmental or conservation organizations.

¹⁹ This is ascertainable from the article of incorporation and by-laws of the donee. The donee must be organized and operated "substantially" or "primarily" for an acceptable conservation purpose.

²⁰ This could prove to be a difficult test to satisfy for relatively smaller charitable organizations.

²¹ Indeed, the Bush Administration has recommended that sanctions be imposed on a charity when a taxpayer claims a charitable contribution deduction for a contribution of a perpetual easement, but the charity fails to monitor and enforce the conservation restrictions or transfers the easement without ensuring that the conservation purposes will be protected in perpetuity.

Conservation Reserve Program long-term policy

By Martha L. Noble

The Conservation Reserve Program (CRP) is a federal Farm Bill conservation program that provides annual rental payments and cost-share payments to landowners who voluntarily retire highly erodible farmland, marginal pastureland, and environmentally sensitive land from intensive agriculture production and establish vegetative cover and other conservation practices on the land.¹ The CRP is the largest federal government program for conservation on private land. In August 2005, USDA reported that a total of 35.6 million acres were enrolled in the CRP² and, in fiscal year 2005, USDA issued \$1.7 billion in CRP payments.³ As of 2003, USDA's Farm Service Agency (FSA) estimated that, compared with 1982 erosion rates, CRP had reduced erosion by over 440 million tons per year on the 34 million acres enrolled in the program. The Natural Resources Conservation Service (NRCS) documented additional benefits including the sequestration of over 16 million metric tons of carbon annually; over 3.2 million acres of wildlife habitat established; and a reduction in the application of nitrogen (by 681,000 tons) and phosphorus (by 104,000 tons). Also, CRP participants had planted about 2.7 million acres to trees, making it the largest federal tree-planting program in history.⁴ A number of studies also document CRP benefits for wildlife, especially in the Upper Great Plains region which has a relatively high concentration of CRP acreage.⁵

As the CRP has approached its maximum acreage enrollment cap of 39.2 million acres, the program has developed a serious structural problem. Between September 30, 2007 and 2010, CRP contracts covering more than 28.7 million acres are scheduled to expire, with about 16 million acres scheduled for expiration in 2007. In August 2004, President Bush announced that USDA would deal with this problem by re-enrolling or extending current CRP contracts. Shortly after the President's announcement, USDA opened a public comment period to gather recommendations for dealing with the management challenge of re-enrolling or replacing almost three-quarters of total authorized CRP acreage over a three-year period, while maintaining CRP's environmental objectives.⁶ USDA also asked for recommendations on improving the design and delivery of CRP to provide natural resource conservation

benefits in the most cost effective manner and recommendations on identifying areas of concern where further research or analysis is required to determine program impacts and performance measures.

The opening of this comment period has given a jump start to debates over the future of the CRP in the next Farm Bill, which is scheduled for re-authorization in 2007. In addition to taking written public comments, USDA held a public meeting on June 24, 2005 to take additional comment on CRP long-term policy.⁷ The Senate Agriculture Committee also held a hearing on CRP oversight in July 2005.⁸ This article describes the main features of the CRP and discusses the USDA plan for re-enrolling and extending CRP contracts that was announced by USDA Secretary Mike Johanns on September 28, 2005. The article then summarizes the positions taken by selected agricultural and conservation organizations in their comments to USDA on CRP long-term policy, in testimony at the Senate hearing this summer, and in other venues. These positions are a prelude to the debate over CRP's future which is emerging in the wider debate over re-authorization of the federal Farm Bill.

Background

The CRP was established by Congress in the Food Security Act of 1985 as a program for the withdrawal of whole farms or fields from agricultural production.⁹ The program was intended to serve two purposes. The primary focus was on conservation – the removal of highly erodible and environmentally sensitive land from row crop production and the establishment of permanent vegetative cover on the land. A secondary purpose was the establishment of a long-term cropland retirement program designed to reduce the production of commodities eligible for Farm Bill commodity subsidies, with a possibility of raising their price through production controls.¹⁰

The program is administered by the FSA with the NRCS providing technical assistance for land eligibility determinations, conservation planning, and conservation practice implementation. Initially, the CRP was implemented as a general sign-up program, with FSA issuing periodic announcements of national sign-ups and landowners bidding competitively to enroll highly erodible or environmentally sensitive land in long-term, 10- to 15-year, CRP contracts. FSA developed an environmental benefits index (EBI) that provides priorities for 5 factors – erosion control, water quality, wildlife, air quality, and enduring benefits – plus a cost factor. The EBI is used by FSA in determining which bids for CRP

enrollment will be accepted. The EBI has been modified and improved from sign-up to sign-up. As of August 2005, 32.4 million acres were enrolled in the general sign-up under 407,642 CRP contracts.¹¹

In 1996, USDA, through administrative regulations under general CRP statutory authority, provided for a continuous CRP sign-up component under which landowners could establish riparian buffers, snow fences, and a variety of in-field conservation practices which do not require that whole fields or farms be withdrawn from agricultural production.¹² There is no competitive bidding process for this program component, and landowners who meet the eligibility requirements may enroll at any time. As of August 2005, 2.4 million acres was enrolled in the continuous CRP component under 250,233 contracts. In addition, USDA also used administrative regulations to establish a Conservation Reserve Enhancement Program (CREP), which provides for agreements between USDA and state governments for geographically targeted initiatives to deal with specific resource problems. The states and other entities provide additional funding that can be used to increase rental rates, pay for permanent conservation easements or for other measures which Congress has not authorized USDA to provide under the CRP. There are currently 31 approved CREP agreements in 26 states, with proposals from six additional states pending approval.¹³ As of August 2005, 681,336 acres was enrolled in the CREP component under 42,990 contracts.¹⁴ CRP also has a Farmable Wetland component to retire small, isolated farmable wetlands, which currently covers 130,875 acres under 8,481 contracts.¹⁵ USDA has also reserved about 3 million acres of CRP acreage for future continuous CRP sign-up, the CREP component, and other special initiatives.

In the 2002 Farm Bill, Congress re-authorized the CRP through 2007 and amended the program by raising the total acreage enrollment cap from 36.4 million acres to 39.2 million acres, adding wildlife as a resource purpose for the program, increasing the allowable economic uses of the land for haying and grazing in return for payment reductions, and requiring that eligible land must have been planted four of the six years preceding enactment of the bill.¹⁶ Congress explicitly recognized and approved the continuous CRP and CREP and converted a six-state pilot Farmable Wetland program into a national program, with an enrollment ceiling of 1 million acres. Eligible wetlands must be smaller than 10 acres, with a maximum of 5 acres eligible for payments.

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The 2002 Farm Bill also retained a provision that limits acreage enrolled in the CRP and the Wetlands Reserve Program to 25 percent of cropland in a county, unless the USDA Secretary provides a waiver after determining that exceeding the limit will not adversely effect the local economy of the county and that agricultural operators in the county are having difficulties complying with conservation plans.¹⁷ This limitation was the subject of debates in the 2002 Farm Bill. Congress addressed the issue by directing USDA to submit a report to Congress that examines: (1) the impact that enrollments in the CRP have on rural businesses, civic organizations, and community services (such as schools, public safety, and infrastructure), particularly in communities with a large percentage of whole farm enrollments; (2) the effect that those enrollments have on rural population and beginning farmers (including a description of any connection between the rate of enrollment and the incidence of absentee ownership); (3) the manner in which differential per acre payment rates potentially impact the types of land (by productivity) enrolled; and (4) the effect of enrollment on opportunities for recreational activities (including hunting and fishing).¹⁸

USDA fulfilled that directive with publication of an Economic Research Service report entitled *The Conservation Reserve Program: Economic Implications for Rural America*.¹⁹ The report concluded that, in the aggregate, the adverse impacts of CRP are generally small and fade over time, and that CRP enrollment can have offsetting beneficial effects on rural communities. But the report also concluded that the regional impacts of CRP vary widely and there are economic sectors, households, and communities that are adversely affected by high levels of CRP enrollment. The report also concluded that whole-farm enrollment was negatively associated with beginning farmer establishment and partial-farm enrollment was positively associated with beginning farmer establishment. This report has become part of the current debate over CRP long-term policy.

USDA's plan for the CRP

On September 28, USDA announced its plan to deal with the Conservation Reserve Program (CRP) contracts covering 28 million acres of land which are scheduled to expire from 2007 to 2010. Fifteen-year contracts expiring September 30, 2007 are not eligible for extension. For other 10- and 15-year contracts, USDA will use the Environmental Benefits Index (EBI) in place when the CRP contracts were first written as the measure of eligibility for contract extension. CRP landowners who ranked in the top 20 percent of the EBI can re-enroll their land in new 10-year CRP contracts, with farmers and ranchers in the ranking with wetlands eligible to re-enroll under a 15-year con-

tract. Landowners with EBI rankings between 61-80 percent can extend their contracts for 5 years; between 41-60 percent can extend contracts for 4 years; between 21-40 percent can receive 3-year extensions; and 20 percent and under in the ranking can extend contracts by 2-years. Eligible participants may re-enroll or extend all or any portion of their existing CRP acres but may not increase the number of acres under contract. In addition, FSA, in determining contract eligibility for re-enrollment and extension, will consider whether the land is located in a national priority area with significant water quality or habitat issues. Currently these areas include the Chesapeake Bay watershed, Long Island Sound watershed, the Great Lakes region, the Prairie Pothole Region of the Northern Plains, and the Longleaf Pine Region in the southeast.²⁰

The Farm Service Agency will be updating the CRP rental rates to reflect current local market rates for cropland on CRP re-enrollments but will use the rates in place, without an update, in CRP contracts that are given short-term extensions. The FSA will also be reviewing cropland enrollment limits on a county-by-county basis. FSA may approve a waiver for CRP and WRP acreage in a county that exceeds the 25 percent statutory limit if the agency finds that there will be no adverse economic impact to the local economy. FSA also announced that it allow local FSA committees to decide whether to lower the acreage limit on a county-by-county basis.²¹

Overview of positions on USDA's long term CRP policy

The opening by USDA of the comment period on CRP long-term policy in 2004 has given a jump start to the debate over the future of CRP in the next Farm Bill. This section of the article provides a summary of positions on CRP long-term policy that have been taken by selected stakeholders over the last year.

A number of hunting and fishing organizations and wildlife conservation groups supported selected re-enrollment of expiring CRP contracts with additional requirements. The National Wildlife Federation supported re-enrollment of expiring CRP contracts limited to contracts with proven benefits in national priority areas or contracts amended with improvements to the structure and composition of vegetative cover to provide appropriate wildlife habitat. The Federation recommended that future re-enrollments, contract extensions, contract lengths and the sign-up of new acreage be managed in order to reduce the number of simultaneous expirations in the future. The Federation also called for an additional general sign-up in 2007 to achieve full CRP enrollment of 39.2 million acres.²² In testimony at a Senate hearing on the Conservation Security Program in July 2005, a number of sporting and conservation

organizations joined a statement documenting the wildlife benefits of the CRP and the benefits of the role of CRP in helping farmers and ranchers diversify their income by incorporating grass-based and recreational-based businesses in their operations. The testimony included support for the contention that CRP has not had an adverse economic effect on rural economies or overall U.S. agricultural production.²³

A coalition of 13 conservation, agricultural, and environmental organizations, including the California Coalition for Food and Farming, Defenders of Wildlife, Environmental Defense, Gulf Restoration Network, National Association of Conservation Districts, National Association of State Conservation Agencies, National Campaign for Sustainable Agriculture, National Catholic Rural Life Conference, Sierra Club, Soil and Water Conservation Society, Sustainable Agriculture Coalition, The Nature Conservancy, and Union of Concerned Scientists, highlighted additional concerns in a letter to FSA in July 2005. The letter highlighted consensus positions on CRP long-term policy.²⁴ The organizations opposed blanket re-enrollment of CRP acreage without competitive bidding into the program under an improved and updated EBI. They also called for USDA to reserve at least 7 million acres in total for CRP contracts under the continuous CRP and the CREP. In addition, they urged FSA to develop transition strategies for CRP land held by landowners who are not going to re-enroll or extend their CRP contracts. These strategies include incentives to use the continuous CRP component to establish conservation buffers and other conservation practices on whole fields that are leaving the CRP program. In addition, these groups urged USDA to encourage landowners leaving the CRP to enroll their land in the Conservation Security Program, which supports whole farm planning and advanced environmental performance on land in agricultural production. Landowners should also be encouraged to apply for the Environmental Quality Incentives Program, Ground and Surface Water Conservation Program, Wildlife Habitat Incentives Program and others USDA conservation programs to provide cost-share and incentives to establish new farming systems on former CRP enrolled land that are in concert with wildlife and the environment. Examples of these farming systems include intensively managed, rotational grazing operations and diverse cropping systems using resource conserving crop rotations. The organizations also urged USDA to explore options and incentives for encouraging retirees or non-farming heirs holding CRP contracts to make arrangements to transfer the land to beginning farmers and ranchers committed to using superior conservation systems.

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The National Farmers Union addressed CRP long-term policy and contract re-enrollment issues in its 2005 Statement of Policy.²⁵ NFU supports full-funding for the CRP but is concerned about adverse impacts on local economies. The NFU supports restructuring of the point system for CRP regarding the amount of land that can be enrolled in a particular area to limit the economic impact CRP has on rural communities. In addition, the policy supports having all CRP lands currently enrolled in the program re-evaluated for contract re-enrollment, rather than having blanket re-enrollments. The most environmentally sensitive land should be given the first opportunity for contract. Land enrolled in CRP that is critical habitat for endangered species should be given an extension of up to 15 years. CRP lands diverted into long-term timber and forestry conservation projects should be given a high priority for contract re-enrollment. NFU also favored CRP contracts and contract extensions for periods of not less than 10 years. NFU policy also addresses land that is leaving the CRP, with support for incentives to aid beginning farm and ranch families to establish agricultural operations on land that was previously enrolled in CRP, but is not environmentally sensitive under the new rules and will not be re-enrolled. In addition, NFU has taken the position that land managed with appropriate standards under USDA's National Organic Program while enrolled in CRP should be eligible for organic certification upon leaving the program.

Other organizations representing agricultural producers have taken less comprehensive positions on CRP long-term policy at this point in time. The American Farm Bureau Federation supported re-enrollment of CRP contracts for the most environmentally significant land with contract extensions of 1- to 5-years, staggered to provide for the enrollment of about 4 million acres per year. The National Cotton Council favored offering automatic early re-enrollment for all CRP contract holders, citing the cost-savings and reduction in USDA staff time needed to administer automatic re-enrollment. The Council also supported staggered enrollments to avoid the logjam of expiring contracts in the future.²⁶ The National Corn Growers Association also submitted brief comments supporting full utilization of the CRP at 39.2 million acres, support for the continuous CRP component, and competitive re-enrollment of CRP land coming out of contract from 2007 to 2010.²⁷

While generally very supportive of the CRP, the Wheat Growers Association has acknowledged that CRP has been a divisive issue among wheat growers since its inception. In testimony to the Senate, the Association's representative included two very different opinions about the program from a survey of farmers by the Montana

Grain Growers Association. One farmer pointed out the importance of conservation, and how the assistance provided through CRP allows the farmer to practice conservation while remaining in business. Another farmer stated that the CRP has been "the most devastating program for rural communities ever devised."²⁸

The Alliance for Agricultural Growth and Competitiveness, a consortium of national and state organizations representing a broad cross-section of meat, livestock and poultry production, agricultural input, grain marketing and handling, feed manufacturing, processing and exporting interests, was the most critical of the CRP.²⁹ The Alliance opposed USDA's stated commitment to full CRP enrollment up to the authorized level of 39.2 million acre. Concerns raised by the Alliance included both the potential adverse impact of CRP on supplies of grain for U.S. agricultural sectors that are grain buyers and on the position of the U.S. in world trade as a major exporter of grain. The group also raised the issue of CRP effects on regional agriculture in communities where a large percentage of cropland was enrolled in the program, as well as concern that automatic re-enrollment of CRP in long-term contracts would usurp the congressional prerogative to adjust the program's goals, objectives, and constraints.³⁰ In response to the USDA's announced plan for re-enrollment and extension of CRP contracts, the Alliance issued a press release supporting USDA's tiered approach for re-enrollment and extensions as far preferable to automatically reenrolling all CRP contracts for 10 years or longer. But the Alliance added that it was disappointed USDA did not require all CRP contract renewal offers to include rental-rate bids that could be evaluated on a competitive basis. The Alliance concluded that USDA's decision to apply "updated" rental rates to CRP contracts reenrolled for 10 years, and allow current rental rates to apply to contracts extended for two to five years will likely result in the re-enrollment of some non-environmentally sensitive acres. The Alliance also expressed disappointment that USDA did not allow early, penalty-free opt-outs of existing acres from the CRP prior to contract maturity.³¹

Conclusion

In the plan for CRP contract re-enrollments and extension announced on September 28, USDA declined a large-scale, blanket re-enrollment of CRP contracts, which could have locked in CRP funding for the next decade. Instead, USDA choose a middle road of long-term re-enrollment of about 20 percent of existing CRP contracts, on relatively environmentally sensitive land, and shorter term extensions for expiring contracts including some that scored quite low on EBIs. The agency declined to address a number of other issues which it

raised in its notice of the comment period on CRP long-term policy. USDA's approach essentially leaves it to Congress to set CRP long-term policy in Farm Bill reauthorization.

The diversity of positions taken in comments submitted to USDA and expressed in other venues indicates that there will be lively debate over CRP in re-authorization of the next Farm Bill. There is strong support for CRP among many hunting and wildlife conservation groups, especially for the general sign-up component which converts whole fields and farms to conserving uses. Other conservation organizations and sustainable agriculture groups support the CRP but would also like to see more program resources directed to the continuous sign-up and CREP components and more attention to local impacts on beginning farmer and rancher access to land and adverse effects on local economies.

Agribusiness interests which benefit from high production levels and lower prices for agriculture commodities are focusing attention on the supply control role played by CRP, a program that has retired millions of acres from row crop production. This role for CRP has also surfaced at USDA. At a House Agriculture Subcommittee hearing in June 2004, FSA Administrator Jim Little indicated that USDA would consider holding a CRP sign-up in 2004 after assessing reports on world crop production estimates. He further explained that with world stocks of commodities tight, it might not be prudent to schedule a CRP sign-up. A congressional representative, Jerry Moran of Kansas, expressed surprise at such an open admission that USDA looks to the CRP as a strategic supply and price control measure.³²

The debate over the design of the CRP will be influenced by numerous factors. Currently, the federal budget is operating in the red and Congress is engaged in a budget reconciliation process that could significantly affect funding for agricultural conservation programs, including CRP, just as Congress begins to engage in Farm Bill re-authorization. The level of funding available for conservation programs could well depend on the level of funding for the Farm Bill's commodity support programs. Commodity program payment limitation measures have recently been introduced in Congress that would transfer funding secured by payment limitations to conservation and other USDA programs. The 2002 Farm Bill also established the Conservation Security Program, which focuses on improving environmental performance on land in agricultural production. The Farm and Ranch Land Protection Program, which provides funds for agricultural land preservation programs, was expanded in the 2002 Farm Bill, as was the Environmental Quality Incentives Program. The balancing of these

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conservation programs, which provide for preservation and environmental improvement of working agricultural land, with the CRP with its greater focus on agricultural land retirement, will be part of the Farm Bill re-authorization debates. Another factor is developments in the World Trade Organization. In 2004, Brazil successfully challenged payments under the U.S. commodity support program for cotton as in violation of World Trade Organization rules. World Trade Organization negotiations over domestic agricultural subsidies which may result in significant changes to WTO rules may also affect the balance of funding between U.S. commodity support programs and programs that provide farmers and ranchers with green payments in return for conservation and environmental performance improvements on their land. All these factors will be under consideration in re-shaping the CRP.

— *Martha L. Noble, Senior Policy Associate, Sustainable Agriculture Coalition, Washington, D.C.*

¹ 16 U.S.C. 3831-3835a.

² USDA, Farm Service Agency, Conservation Reserve Program – Monthly Summary (August 2005) at <http://www.fsa.usda.gov/dafp/cepd/stats/Aug2005.pdf>. FSA issues monthly reports with CRP statistics including acreage enrollment by program component, state, and conservation practices.

³ Johanns Announces \$1.7 Billion in Conservation Reserve Program Payments (USDA Press Release No. 0422.05)(Oct. 5, 2005) (posted on the web at <http://www.fsa.usda.gov/pas/FullStory.asp?StoryID=2204>).

⁴ See Barbara Johnson, Conservation Reserve Program: Status and Current Issues (Feb. 4, 2005)(CRS Report for Congress) at <http://www.ncseonline.org/NLE/CRS/abstract.cfm?NLEid=53286>.

⁵ See, e.g., Ronald E. Reynolds. 2000. *Waterfowl Responses to the Conservation Reserve Program in the Northern Great Plains*, in L. P. Heard et al., A comprehensive review of farm bill contributions to wildlife conservation, 1985-2000 (posted at <http://www.npwrc.usgs.gov/resource/birds/wfrespon/wfrespon.htm>).

⁶ Commodity Credit Corporation, Conservation Reserve Program—Long-term Policy, 69 Fed. Reg. at 48447-48451 (Aug. 10, 2004).

⁷ Notice of a Meeting on the Conservation Reserve Program, 70 Fed. Reg. at 32564-32565 (June 3, 2005).

⁸ Hearing on Oversight of the Conservation Reserve Program, Subcommittee on Forestry, Conservation and Rural Revitalization of the Senate Agriculture Committee (July 27, 2005)(hereinafter Senate CRP Hearing), testimony posted on the web at <http://agriculture.senate.gov/Hearings/hearings.cfm?hearingid=1578>.

⁹ Food Security Act of 1985, P.L. 99-198, §§1231-1235.

¹⁰ For a discussion of the role of CRP as a supply control measure, see Zachary Cain & Stephen Lovejoy, *History and Outlook for Farm Bill Conservation Programs*, Choices (4th Quarter 2004) at pp. 37-42.

¹¹ USDA, Farm Service Agency, Conservation Reserve Program – Monthly Summary (August 2005) at <http://www.fsa.usda.gov/dafp/cepd/stats/Aug2005.pdf>.

¹² 7 C.F.R. § 1410.30. Congress explicitly recognized the continuous CRP sign-up in the 2002 Farm Bill.

¹³ See 7 C.F.R. § 1410.50. Congress explicitly recognized the CREP in the 2002 Farm Bill. FSA has posted detailed information about the CREP program on the web

at http://www.fsa.usda.gov/dafp/cepd/state_updates.htm.

¹⁴ USDA, Farm Service Agency, Conservation Reserve Program – Monthly Summary (August 2005) at <http://www.fsa.usda.gov/dafp/cepd/stats/Aug2005.pdf>.

¹⁵ *Id.*

¹⁶ Farm Security and Rural Investment Act of 2002, P.L. 107-171, §2101.

¹⁷ 16 U.S.C. § 3843(b).

¹⁸ *Id.*, § 2101, 116 Stat. 252 (codified as a note to 16 U.S.C. § 3831).

¹⁹ See Patrick Sullivan et al., The Conservation Reserve Program: Implications for Rural American (USDA, Economic Research Service Agricultural Economic Report No. 834 (Oct. 2004) posted on the web at <http://www.ers.usda.gov/publications/aer834/> (initially prepared as USDA, Economic Research Service Report to Congress, Conservation Reserve Program: Economic and Social Impacts on Rural Counties (Feb. 2004).

²⁰ See FSA, Fact Sheet: Conservation Reserve Program Contract Re-enrollments and Extensions (Sept. 2005) at <http://www.fsa.usda.gov/pas/publications/facts/html/crpreenroll05.htm>.

²¹ *Id.*

²² Comment Letter of the National Wildlife Federation on CRP Long-term Policy submitted to the USDA Farm Service Agency (Dec. 8, 2004) at <http://www.huntingandfishingjournal.org/archives/issues/CRP%20NWF%20Comment%20Letter%204%20-%20HQ%20FINAL%20VERSION.pdf>.

²³ Testimony of Jeffrey W. Nelson, Director of Operations, Ducks Unlimited, Inc., representing the views of the Archery Trade Association, Bowhunting Preservation Alliance, Ducks Unlimited, International Association of Fish and Wildlife Agencies, Izaak Walton League of America, National Wild Turkey Federation, North American Grouse Partnership, Pheasants Forever, Safari Club International, Texas Wildlife Association, Theodore Roosevelt Conservation Partnership, Whitetails Unlimited, and Wildlife Management Institute, posted on the web at <http://agriculture.senate.gov/Hearings/hearings.cfm?hearingid=1578&witnessid=4537>.

²⁴ A copy of the letter is included in a Sustainable Agriculture Coalition press release dated Sept. 29, 2005, posted on the web at <http://www.msawg.org/pdf/SAC-CRP-PressRelease-9-29-05.pdf>.

²⁵ Policy of the National Farmers Union, Enacted by Delegates to the 103d Anniversary Convention, Lexington, KY (Feb. 25-28, 2005) at pp. 63-64 at www.nfu.org/documents/policy/2005_nfu_policy_e.pdf.

²⁶ NCC Comments on the Long Term Policy of the Conservation Reserve Program (Dec. 8, 2004) at <http://www.cotton.org/issues/2004/128crpcomments.cfm>.

²⁷ Comment letter of the National Corn Growers Association to Robert Stephenson, FSA (Dec. 13, 2004) at <http://www.ncga.com/news/notd/2004/pdfs/Conservation%20-%20CRP%20Comments1.pdf>.

²⁸ Testimony of Sherman Reese, President, National Association of Wheat Growers, Senate CRP Hearing at <http://agriculture.senate.gov/Hearings/hearings.cfm?hearingid=1578&witnessid=4534>.

²⁹ Comments to USDA submitted by the Alliance for Agricultural Growth and Competitiveness (June 24, 2005), signed by members including the Agricultural Retailers Association, American Bakers Association, American Feed Industry Association, CHS Inc., Food Products Association, Grain & Feed Association of Illinois, Independent Bakers Association, Kansas Grain & Feed Association, Louis Dreyfus Corp., Michigan Agribusiness Association, Michigan Bean Shippers, National Chicken Council, National Grain and Feed Association, National Grain Trade Council, National Oilseed Processors Association, National Turkey Federation, North American Export Grain Association, North American Millers' Association, North

Dakota Grain Dealers Association, Oklahoma Grain & Feed Association, Pet Food Institute, Texas Grain & Feed Association, The Biscuit & Cracker Manufacturers' Association, The Fertilizer Institute, The Scoular Co., United Grain Corporation, and United Harvest LLC (posted at www.namamillers.org/word/CRPCommentsUSDA.doc).

³⁰ Testimony of Kendall Keith, President of the National Grain and Feed Association, Senate CRP Hearing at <http://agriculture.senate.gov/Hearings/hearings.cfm?hearingid=1578&witnessid=4535>.

³¹ Press Release, Alliance for Agricultural Growth and Competitiveness, Groups Express Concern Over Long-Term Impacts of USDA's Decision on CRP Reenrollment, Extensions (Sept. 28, 2005)(posted at http://www.ngfa.org/pdfs/Statement_USDA_CRP_Reenrollment_Announcement_9-28-05.pdf).

³² Hearing to Review the Implementation of the Conservation Title of the Farm Security And Rural Investment Act Of 2002, Before the House Agriculture Subcommittee on Conservation, Credit, Rural Development and Research (108th Cong.) June 15, 2004) (Serial No. 108-32) at pp. 11-14.

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or maintenance of management or vegetative practices would not be excludible from income nor would "existing practice, new practice, and enhancement activity payments"⁹ necessarily be excludible from income. Those payments are very likely to be reportable as ordinary income except to the extent the payments are for capital improvements.¹¹

The misleading statement in the June 24, 2005 Notice has contributed to the belief by some taxpayers, augmented by statements from Natural Resource Conservation Service offices, that perhaps the entire amount of CSP payments could be excluded from income. That would only be possible if the entire payment amount were to be directed into capital improvements. Considering the nature of the CSP program, that is highly unlikely.

— Neil E. Harl,* Iowa State University.

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¹ Farm Security and Rural Investment Act of 2002, section 2001, 116 Stat.134 (2002).

² 7 C.F.R. Part 14.

³ 70 Fed. Reg. 36,557 (June 24, 2005).

⁴ I.R.C. section 126(b)(1)(A).

⁵ I.R.C. section 126(b)(1)(B).

⁶ 70 Fed. Reg. 336,557 (June 24, 2005)(Emphasis added).

⁷ Harl, *Reporting Conservation Security Program Payments*, 16 Agric. L. Dig. 169, 170 (2005).

⁸ See Temp. Treas. Reg. section 16A.126-1(a).

⁹ *Id.*

¹⁰ 70 Fed. Reg. 36,557 (June 24, 2005).

¹¹ See note 8 supra.

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