It Takes Money to Make Money: A Beginning Farmer's Loan Tool Box

by

Patrick B. Dillon

Originally published in DRAKE JOURNAL OF AGRICULTURAL LAW
8 DRAKE J. AGRIC. L. 725 (2003)

IT TAKES MONEY TO MAKE MONEY: A BEGINNING FARMER'S LOAN TOOL BOX

*Patrick B. Dillon**

---

* Patrick B. Dillon, Juris Doctorate, Drake University Law School (December 2003); B.S. Agricultural Studies (with Distinction), Iowa State University.

I. INTRODUCTION

While the purchase of land is often a major focus of a beginning farmer, it may not be the best use of limited resources. In fact, it may be the last thing a beginning farmer should purchase.[1] However, the goal of land ownership is considered critical by some and desirable by many.[2] Acknowledging this basic desire to own land and finding ways to accomplish it effectively are important steps in successful beginning farm operations.

This Note focuses on strategies and potential ways to purchase land effectively through the use of existing governmental programs. While clearly each farm purchase is fact-intensive and not all proposed solutions will work for all situations, this Note's intent is to stimulate thought and develop understanding of the existing means for aspiring farmers to enter the market. This Note will discuss laws and programs available from both Iowa and the federal government. For example, Iowa's Beginning Farmer Loan program is the largest of its kind in the nation.[3]

Using tools in a tool box as a metaphor, the two main options available to a beginning farmer are the Iowa Agricultural Development Authority ("IADA") programs[4] and the federal Farm Service Agency ("FSA") loans.[5] These can be thought of as the 9/16 and 1/2 inch wrenches for the beginning farmer. Each program can be used in multiple ways just like wrenches have an open end and closed end,` i.e., "box end," depending on what fit is required. Both ends of a wrench are useful, versatile, and a likely fit for many jobs, but each is just a little different, just like the various loan programs. Of special note is the potential to combine these two loan programs, extending extra capital to

1. *See* JOHN BAKER, FARM SAVVY MANUAL 102 (2002) (noting that the transfer of land and other long term assets comes at the end of a business asset transfer cycle).

2. Dave McAllister, *Beginning Farmer Programs*, SMALL FARM DIG., Spring-Summer 2002, at 6.

3. *See* Rod Swoboda, *Beginning Farmer Loans*, WALLACES FARMER, Mar. 2000, at 26.

4. IOWA AGRIC. DEV. AUTH., IOWA BEGINNING FARMER LOAN PROGRAM: PROGRAM SUMMARY 1 (June 2001).

5. FSA, USDA, FACT SHEET: FARM LOAN INFORMATION (Sept. 2002), *available at* http://fsa.usda.gov/pas/publications/facts/html/farmloaninfo02.htm.

the beginning farmer.[6] The discussion of these tools will also include judicious use of the capital gains exception for the sale of a principle place of residence,[7] and the potential advantages of sales via private contracting versus financing through a bank. Some of the potential "specialty tools" that will be examined include: less well known governmental programs, use of life estates, and use of conservation easements sold to and funded by private, qualified organizations[8] or governmental agencies.[9]

II. THE 9/16 INCH WRENCH—IOWA AGRICULTURAL DEVELOPMENT AUTHORITY PROGRAMS

The IADA has two types of bond programs available to beginning farmers, the Loan Participation Program ("LPP") and the Beginning Farmer Loan Program ("BFLP").[10]

A. *The Box End of the 9/16 Inch Wrench—Loan Participation Program (LPP)*

The LPP program requires: 1) certification that no private or state credit can be obtained (although the FSA does not have to certify the denial);[11] 2) a maximum funding of thirty percent of the purchase price or $100,000;[12] 3) a maximum net worth of no more than $300,000 (with a maximum $400,000 debt prior to closing);[13] 4) a debt to asset ratio of no greater than eighty percent, with the loan to net worth ratio no greater than two hundred percent;[14] and 5) off-farm income of no more than fifty percent of projected total income.[15]

---

6. *See* Rod Swoboda, *Start up Cash for Start Up Farms*, WALLACES FARMER, Sept. 2002, at 14.
7. I.R.C. § 121 (2002).
8. Examples of agencies that purchase private conservation easements include the Iowa Heritage Foundation and The Nature Conservancy. IOWA NATURAL HERITAGE FOUND., THE LAND OWNER'S OPTION 39-40 (5th ed. 1999).
9. This would include the U.S. Fish and Wildlife Service, National Park Service, Iowa Department of Natural Resources and local Soil and Water Conservation Districts. *Id.* at 41-42.
10. IOWA AGRIC. DEV. AUTH., *supra* note 4, at 15.
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.*
15. *Id.*

This program can be used in conjunction with the Beginning Farmer Loan Program, conceivably as a source of down-payment.[16] The applicant must be qualified under both of the programs to use them concurrently.[17]

B. *The Open End of the 9/16 Inch Wrench—Beginning Farmer Loan Program (BFLP)*

The Beginning Farmer Loan Program requires the participant not own substantial farm land (i.e., no more than thirty percent of the median county acreage)[18] and the maximum net-worth of the participant is under $300,000.[19] In addition, the maximum loan allowed to obtain favorable federal income tax treatment is $250,000.[20]

Under the BFLP, a "beginning farmer" is anyone who is over eighteen years old and is considered a first-time farmer.[21] A "first-time farmer" is an "individual who has never had any direct or indirect ownership" in land that was more than thirty percent of the median county farm size and never had more than a value of $125,000 while the individual held any such interest.[22] Ownership or material participation by a spouse or minor child will also be attributed to the individual.[23] Federal tax law provides that a prior ownership interest can be disregarded if the ownership was terminated when the applicant was insolvent and if the Internal Revenue Service, in applying Code Section 108, had not viewed cancellation of debt as income from the farmland.[24] Also, an individual who holds an interest in a family farm corporation, limited liability partnership, trust, or other entity that owns more than thirty percent of the median size farm in a county, "and the individual materially participates in the operation," shall be excluded.[25] Treasury Regulation Section 1.469-5T(a) sets out a seven-pronged test for meeting the material participation requirement in taxation:

1) the individual participates in the activity for more than five hundred hours during the tax year;

---

16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.* at 3.
22. *Id.* at 3, 12.
23. *Id.*
24. *Id.* at 12; *see* I.R.C. § 108(a)(1)(C) (2002); I.R.C § 147(c)(2)(C)(iii) (2002).
25. IOWA AGRIC. DEV. AUTH., *supra* note 4, at 12.

2) the taxpayer's participation in the activity is substantially all of the participation in the activity by all individuals;

3) the taxpayer participates in the activity for more than one hundred hours during the tax year, and participates for at least as many hours as any other individual;

4) the activity is a significant participation activity, and the taxpayer's participation in all significant participation activities during the year exceeds five hundred hours;

5) a taxpayer who materially participated in an activity during five of the past 10 years (without regard to this test) is treated as materially participating in the current year;

6) a taxpayer who has materially participated in a personal service activity for at least three years will be treated as materially participating in that activity for the rest of the taxpayer's life; and,

7) a taxpayer who participates for more than one hundred hours and, based on the facts and circumstances, participates on a regular, continuous, and substantial basis, is treated as materially participating.[26]

It should be noted that thirty percent of the median county farm size varies widely from county to county. The average size in 1999 was 65.90 acres for the entire State of Iowa; however, as an example of the county variance, Adair County averaged 75.3 acres while Bremer County only allowed 41.1 acres to be held.[27]

III. The 1/2 Inch Wrench—Farm Service Agency Loans

The 1/2 inch wrench is a frequently used tool in most tool boxes. Likewise, the Federal Farm Service Agency has a number of loans that are used by beginning farmers. Some FSA loans are specifically targeted to beginning farmers, however, the beginning farmer always remains free to compete with the general public for traditional FSA loans.[28]

---

26. Treas. Reg. §1.469-5T(a) (2003).
27. *See* Iowa Agric. Dev. Auth., *supra* note 4, at 14.
28. *See* FSA, USDA, Producer's Guide to FSA Loan Programs 13 (July 2000).

A. *The Box End of the 1/2 Inch Wrench—Beginning Farmer Down Payment Farm Ownership Loan*

The first loan examined is referred to as the "10-40-50,"[29] or the Beginning Farmer Down Payment Farm Ownership Loan. This loan is directly targeted at beginning farmers.[30] Under this program, a beginning farmer makes a down payment of ten percent.[31] Forty percent of the purchase or appraised value price, up to $250,000, will be financed by the FSA directly at four percent interest over fifteen years.[32] The remainder can be financed by a private lender, with the FSA providing up to a ninety-five percent guarantee and participating lenders having the option of requiring a guarantee fee.[33] In fifteen years, the farmer ends up with fifty percent equity in the land. Funding for this targeted beginning farmer program appears to be sufficient.[34]

B. *The Open End of the 1/2 Inch Wrench—Participation Loan Program*

On the other end of the FSA wrench is the "Participation Loan Program," commonly called the "50-50 loan"[35] or the "Joint Financing Plan."[36] This loan provides fifty percent of the loan amount directly from the FSA, including a reduced interest rate, with the other fifty percent coming from any other source.[37] This program is not specifically targeted for beginning farmers, and sometimes funds allocated under this program may be unavailable.[38]

---

29. Telephone Interview with Chris Beyerhelm, Farm Program Specialist, FSA (Oct. 18, 2002).

30. 7 C.F.R. § 1943.14(a), (h) (2002); *see* FSA, *supra* note 28, at 6; *see also* FSA, USDA, FACT SHEET: LOANS FOR BEGINNING FARMERS AND RANCHERS (Dec. 2002), *available at* http://www.fsa.usda.gov/pas/publications/facts/html/begloan02.htm.

31. 7 C.F.R § 1943.14(d) (2002); FSA, *supra* note 30.

32. 7 C.F.R. § 1943.14(d)(2), (4)(e) (2002); FSA, *supra* note 30.

33. FSA, *supra* note 30.

34. Telephone Interview with Chris Beyerhelm, *supra* note 29.

35. Swoboda, *supra* note 6.

36. FSA, *supra* note 30.

37. *Id.*

38. Telephone Interview with Chris Beyerhelm, *supra* note 29.

C. *Qualifications under the FSA Programs*

To qualify as a beginning farmer, an applicant must have at least three, but no more than ten, years of farming experience.[39] While objective proof, like three years worth of Schedule F, 1040 Tax Returns showing farm income, may be preferred,[40] the FSA is flexible as to what constitutes proof of three years experience. The focus is on real management decisions, not the "hired man" phenomena (in which the younger generation simply executes the directives of the older generation, without real input regarding decisions).[41]

If the FSA has any question regarding an applicant's experience level, the county FSA board, elected by the local farmers of the county,[42] can conduct an inquiry to determine if the applicant truly has farm experience.[43] The farm operation must also be a family farm.[44] The factors examined to determine whether a farm merits "family farm" status include: 1) whether or not it is recognized in the community as a farm (for example, most families provide the labor on family farms, with the exception of high-value, labor intensive crops like fruits and vegetables);[45] 2) whether or not its management and control is made by the members of the family (though, this does not preclude the use of consultants, advisors, or other experts;[46] 3) whether or not there is use of seasonal labor, meaning the majority of the work should come from the farm family;[47] and, 4) the relative need of FSA credit as a percentage of the total credit of the farm operation.[48]

While agribusiness entities such as family partnerships and limited liability companies can apply for beginning farmer loan programs via the FSA, all members of the business entity must meet the eligibility requirements for the program.[49]

---

39. 7 C.F.R. § 1943.4(b) (2002); FSA, *supra* note 28, at 13.
40. Telephone Interview with Chris Beyerhelm, *supra* note 29.
41. *Id.*
42. FSA, USDA, FACT SHEET; COUNTY COMMITTEE ELECTION (July 2002), *at* http://www.fsa.usda.gov/pas/publications/facts/html/elec02.htm.
43. Telephone Interview with Chris Beyerhelm, *supra* note 29.
44. 7 C.F.R. § 1943.14(a) (2002).
45. FSA, USDA, FSA HANDBOOK, GUARANTEED LOAN MAKING AND SERVICING FOR STATE AND COUNTY OFFICES ¶ 109, 8-7 (1999); 7 C.F.R. § 762.120(i) (2002).
46. *Id.*
47. *Id.*
48. FSA, *supra* note 45 at 8-8.
49. 7 C.F.R. § 1943.4(g) (2003); Telephone Interview with Chris Beyerhelm, *supra* note 29.

IV. WHICH WRENCH FITS?

A. *Disadvantages*

No loan program is right for every situation. For example, BFLP is not an eligible program for partnerships, L.L.C.s, or corporations.[50] Those business entities are considered ineligible under the Federal Tax Code.[51] While many farms continue to operate as sole proprietorships,[52] this may not be in the best interests of farmers, due to unlimited liability potential and few tax advantages.[53]

Furthermore, a condition of the BFLP requires the beginning farmer, along with a spouse and minor children (if any), to provide the labor and management.[54] This appears to preclude a beginning farmer from purchasing land and then subsequently forming an agribusiness entity to shield him from personal liability, as well as precluding him from taking advantage of perceived tax advantages gained by use of an agribusiness entity, such as a closely held family corporation or limited liability company.

This restriction also prevents rental of the farm property [55] or enrollment of acres purchased with bond funds into the Conservation Reserve Program ("CRP").[56] Also, to purchase the farm with BFLP funds, no more than twenty-five percent (twenty percent if a dwelling is purchased) of the farm's acreage can be enrolled in the CRP program at the time of purchase.[57]

Additionally, contract sales between close relatives (such as between a person and his parents or grandparents) are prohibited.[58] Third-party lenders, however, may facilitate the sale between close relatives using the BFLP.[59]

---

50. IOWA AGRIC. DEV. AUTH., *supra* note 4, at 2.

51. *See* I.R.C. § 147(c)(i) (2000) (stating that a first time farmer is an individual); *see also* IOWA AGRIC. DEV. AUTH., *supra* note 4, at 2.

52. JOHN R. BAKER ET AL., FARM SUCCESSION IN IOWA 14 (2003) (stating that seventy-five percent of Iowa farmers surveyed are organized as sole proprietorships).

53. James Monroe, *Agribusiness Tax Planning,* 4 DRAKE J. AGRIC. L. 407, 412 (1999).

54. IOWA AGRIC. DEV. AUTH., *supra* note 4, at 4.

55. IOWA AGRIC. DEV. AUTH., BEGINNING FARMER LOAN PROGRAM, FREQUENTLY ASKED QUESTIONS, Question 2(E), *available at* http://www.iada.state.ia.us/program-eligibility-pub.htm (last visited Nov. 10, 2003).

56. *Id.*

57. *Id.*

58. IOWA AGRIC. DEV. AUTH., *supra* note 4, at 4.

59. *Id.*

While many beginning farmers are eager to use the beginning farmer programs, it may require a bit of salesmanship to convince a seller to employ the program.[60] A seller will soon realize IADA loans take nearly three months to complete after the negotiations have finished.[61] Retirement is often not on the minds of Iowa farmers.[62] Estates or landowners in need of quick cash may not be amenable to the delays built into the IADA loans.

Another potential problem faced by non-contract farm sales is the restriction that the beginning farmer must not make any expenditure with respect to acquisition or construction of any part of the project prior to sixty days of the approval of the bond, or it may be deemed a refinancing.[63] If the Internal Revenue Service deems the bond a refinancing, tax-exempt bonds cannot be used.[64] This restriction forces those in need of quick cash to use contract sales or bypass the IADA loan programs altogether.

While these problems are limitations, one perceived limit is actually a benefit, the limit on funding of a purchase of farmland with a dwelling by the BFLP.[65] Under the BFLP, only five percent of the loan can be attributed to the dwelling, determined after a formal appraisal of the land is conducted.[66] No doubt this prevents abuse of the program by those seeking a rural-living lifestyle, not a farming operation.

If the seller has been living at the residence two of the last five years, the sale may then qualify as a sale of a principal place of residence.[67] This distinction is critical because, under Internal Revenue Service Code Section 121, the gain on the sale of a principal place of residence is excluded from capital gains tax.[68] This becomes a windfall to the seller and an attractive selling point for the use of the BFLP.

---

60. STEVE SCHWARTZ ET AL., CALIFORNIA FARMLINK, LESSONS IN FARM TRANSITION POLICY 8 (Aug. 2000) (citing ratios of hopeful beginning farmers to participating retiring farmers in Farm Link programs as high as 10:1).

61. *See* IOWA AGRIC. DEV. AUTH., *supra* note 4, at 6 (listing requirements for public hearing on bond issue and governor's approval); IOWA AGRIC. DEV. AUTH., *supra* note 55, at Question 7 (noting that 2.5 months will be needed to complete the process).

62. BAKER ET AL., *supra* note 52, at 10 (stating that seventy-three percent of Iowa farmers surveyed never plan to get past semi retirement).

63. IOWA AGRIC. DEV. AUTH., *supra* note 4, at 5.

64. IOWA AGRIC. DEV. AUTH., *supra* note 4, at 4; *see also* I.R.C. § 144(a) (2000); Treas. Reg. § 1.150-2 (2003).

65. IOWA AGRIC. DEV. AUTH., *supra* note 4, at 11.

66. *Id.*

67. I.R.C. § 121 (2000).

68. *Id.*

The question then becomes how much value should be assigned to the dwelling. The seller will want to maximize his Section 121 deduction, while the buyer will presumably want as much of the price as possible to be attributed to the land, to ensure a high basis. While no case law has firmly established what a rural residence is, it is helpful to remember the principle of "too much."[69] As noted in the courts, "when a pig becomes a hog, it is slaughtered."[70] Any parcel of land is substantial farmland unless it is smaller than thirty percent of the median size farm in the county where it is located and the fair market value has never exceeded $125,000.[71] Thirty percent of the median size farm in Iowa in 2001 was 65.9 acres.[72] A homestead exception in Iowa bankruptcy law is forty contiguous acres, including the buildings.[73] Reasonably, enough acres must be assigned to the dwelling site to make it a marketable property in the event of forfeiture.

B. *Advantages*

One of the biggest benefits to the seller is the exemption from federal and state income tax on the interest earned from a contract sale under the BFLP.[74] This benefit is tempered by the requirement that the seller set the interest rate one to four percentage points below the current market rate.[75] Even with a reduced interest rate, because of the tax free nature of the income, an interest free five percent is competitive with a taxable seven percent.[76]

Additionally, the contract seller is able to deal directly with the beginning farmer. This avoids the sales commission that a real estate broker would otherwise take from the gross amount of sale.[77] Real estate brokerage fees and

---

69. Dolese v. United States, 605 F.2d 1146, 1154 (10th Cir. 1979).

70. *Id.*

71. IOWA AGRIC. DEV. AUTH., *supra* note 4, at 12.

72. *Id.* at 14.

73. IOWA CODE ANN. § 654.16 (West 2003).

74. IOWA AGRIC. DEV. AUTH., BENEFITS OF USING THE BEGINNING FARMER LOAN PROGRAM (2003), *available at* http://www.iada.state.ia.us/program-benefits.htm.

75. *Id.*

76. For example, assuming a tax rate of 28% and $1000 of principal generates $50 of tax-free interest to the seller ($1000 x .05=$50). That same $1000 of principal, with a reduced interest rate of 7%, also subject to a 28% federal tax and 9% state tax, generates $46.23 of tax-free interest to the seller. ($1000 X .07=$70. $70 X .28 (federal tax rate) =$19.20. $70-$19.20= $50.80. $50.80 x .09 (state tax rate) =$4.57. $50.80-4.57= $46.23 net.

77. *See* BUREAU OF LAB. STATISTICS, U.S. DEP'T OF LAB., OCCUPATIONAL OUTLOOK HANDBOOK: REAL ESTATE BROKERS AND SALES AGENTS (2002), *at* http://www.bls.gov/oco/ocos120.htm (last visited Jan. 8, 2003) (showing that agents get commis-

commissions accounted for 77.2% of revenue source for the real estate industry in 1997.[78] Clearly, the use of private contracts will keep this money in the hands of the seller.

If a seller is not comfortable with a contract sale and elects to use a lending institution, the lender will reap the benefit of the federal, but not the state, tax exemption.[79] The bank can also establish a customer for operating loans and with such loans qualify for the Community Reinvestment Act (CRA).[80]

V. BOTH WRENCHES—COMBINING THE PROGRAMS

In some situations, more than one wrench is needed to get the job done. Fortunately, both wrenches, the IADA program and the FSA loan programs, can be used in conjunction with one another.[81] The BFLP can be combined with the FSA's Loan Participation Program to increase the amount of money available to finance farm purchases.[82] This is not the same as the FSA guaranteeing the BFLP loan, which in the eyes of the IRS is double-dipping.[83]

Therefore, on a farm with a dwelling site, the solution utilizing the BFLP most effectively may be a separate purchase of the dwelling without using BFLP funds.[84] This would entail a separate purchase of the dwelling from another funding source. For example, the FSA loan programs make no such restrictions on dwelling sites.[85] The FSA is not interested in funding rural housing, but would fund a concurrent purchase of a parcel that had a dwelling on it, if it was demonstrated that the purchase was part of a farm operation.[86]

Using another loan program in conjunction with a BFLP purchase, is a matter of ensuring the dwelling sight is allocated to the portion of the purchase

---

sions on sales).

78. U.S. CENSUS BUREAU, 1997 ECONOMIC CENSUS, REAL ESTATE AND RENTAL AND LEASING 7 (2000).

79. IOWA AGRIC. DEV. AUTH., *supra* note 74.

80. *Id.*

81. *Cf.* 7 C.F.R. § 1943.14(g) (2003) (authorizing FSA partnerships via Memorandum of Understanding with state beginning farmer loan programs). However, Iowa has no formal Memorandum of Understanding with the FSA but works with the FSA closely on all loan applications. Telephone Interview with Jeff Ward, Director, Iowa Agricultural Development Authority (Feb. 12, 2002).

82. IOWA AGRIC. DEV. AUTH., *supra* note 74; *see also* Swoboda, *supra* note 6, at 14.

83. I.R.C. § 149(b) (2000); IOWA AGRIC. DEV. AUTH., *supra* note 55, at Question 16.

84. *See* IOWA AGRIC. DEV. AUTH., *supra* note 4, at 11 (recalling that only five percent of the appraised value can be assigned to a house in a BLFP-funded purchase).

85. *See generally* FSA, *supra* note 28.

86. Telephone Interview with Chris Beyerhelm, *supra* note 29.

funded by the other loan program. Because the BLFP has a $250,000 limit, combining an extra $200,000 from the FSA "50-50" program, would enable a purchase of up to $400,000.[87] This combination of the loan programs allows the beginning farmer to compete in today's high-value land market.[88]

VI. OTHER TOOLS

While wrenches have solved many problems, sometimes more specialized tools are required. Therefore, an examination of the tools that may not be used as often for beginning farmers, unless the right situation presents itself, is warranted.

A. *The Allen Wrench—Other Government Programs*

Like the Allen wrench in the tool box, the federal government has programs that seem on the surface to be of limited value. For example, the FSA gives beginning farmers first priority to purchase land for seventy-five days after acquisition by the FSA.[89] This, of course, is something that cannot be easily sought out or foreseen, and should be viewed as a "target of opportunity."

In another example, the Environmental Quality Incentives Program ("EQIP") was modified by the 2002 Farm Bill to provide equal opportunity for beginning farmers to participate.[90] The bid-down procedure (in which farmers who were willing to pay more of the cost were given priority) was eliminated.[91] Also, payment procedures are now more prompt.[92]

---

87. Swoboda, *supra* note 6, at 14; *see generally* FSA ONLINE, *supra* note 5.

88. *See Farmland Tops $2,000 an Acre Average Value in Iowa in 2002*, U.S. FARM NETWORK.COM, *at* http://usfarmnetwork.com/decrelease.html (last visited Jan. 8, 2003); *see also* Swoboda, *supra* note 6, at 14 (stating that as real estate prices have climbed, loan requests often go over the BLFP limit).

89. FSA, *supra* note 28, at 13.

90. NRCS, USDA, FACT SHEET: FARM BILL 2002, CONSERVATION OPPORTUNITIES FOR: AMERICAN INDIANS AND ALASKA NATIVES, BEGINNING FARMERS AND RANCHERS, LIMITED RESOURCE FARMERS AND RANCHERS (Nov. 2002), *available at* http://www.nrcs.usda.gov/programs/farmbill/2002/pdf/ConOpFS.pdf.

91. *Id.*

92. *Id.*

B. *Claw Hammer—Life Estates*

Another tool available to the beginning farmer is granting a simple life estate to the current owner. Like a claw hammer wielded without precaution, life estates can be the source of headaches. In retaining a life estate, the seller will be able to stay on the land, which could sometimes be a big obstacle,[93] while transferring the land title, which the beginning farmer desires.[94] This retention of a property right would conceivably reduce the cost of the land as well. The life estate also fosters a working relationship between the buyer and seller, which may encourage use of a private land sale contract and allow the older generation to share "historical data" about the farm that may lead to avoidance of learning costly lessons by the new farm operator. The granting of a life estate should be done after careful consideration of personalities and should be restricted to prevent the life estate holder from transferring his interest to another party.

C. *Locking Jaw Pliers—Conservation Easements*

Locking jaw pliers can be used for a temporary fix or a final fix to a situation. Similarly, conservation programs offer term easements or lifetime easements. Usually, conservation easements are considered part of the protection of assets in estate planning, not farm purchases.[95]

Selling a conservation easement when purchasing property is an area of great potential.[96] In the long run, an easement helps a farmer's bottom line by reducing taxes and payments on principal.[97] After granting an agricultural conservation easement, landowners still retain property rights, can still restrict public access, and retain eligibility for state and federal farm programs.[98]

---

93. *See generally* BAKER ET AL., *supra* note 52, at 10 (stating that seventy-three percent of Iowa farmers surveyed never plan to get past semi-retirement).

94. *See generally* McAllister, *supra* note 2, at 5.

95. *See generally* IOWA NATURAL HERITAGE FOUND., *supra* note 8; JEREMIAH P. COSGROVE & JULIA FREEDGOOD, YOUR LAND IS YOUR LEGACY (3d ed. 2002) (explaining conservation easements as part of a land transfer).

96. CALIFORNIA FARM LINK, FARM TRANSITION CASE STUDY 3: IMPACT OF A BARGAIN SALE OF AN EASEMENT FOR A BEGINNING FARMER, *available at* http://www.californiafarmlink.org/pdfs/Case_Study_3.pdf (last visited Nov. 11, 2003).

97. IOWA CODE § 441.21(1)(b) (2003); CALIFORNIA FARM LINK, *supra* note 96.

98. *See* FARMLAND INFO. CTR., AM. FARMLAND TRUST, FACT SHEET: AGRICULTURAL CONSERVATION EASEMENTS 1 (2001), *available at* http://www.farmlandinfo.org/documents/27762/ACE_1-04.pdf.

Landowners can use the benefit of a qualified conservation easement.[99] A qualified conservation easement for reduction of gross estate or charitable contribution is defined by Internal Revenue Code Section 170(h).[100] To receive all exclusions the contributed land must transfer a qualified real property interest to a qualified organization exclusively for conservation purposes.[101]

A qualified real property interest includes a remainder interest, the entire interest, or a restriction granted in perpetuity.[102] A qualified organization is allowed to receive such an interest if it meets certain requirements set out in Internal Revenue Code Section 170(h).[103] A qualified conservation purpose is the preservation of land for recreation or education of the public, or protection of natural fish, wildlife, or ecosystems, or open space preservation (including farm and forest land), where the preservation is for the scenic enjoyment of the public or pursuant to a federal, state, or local conservation policy or historically important land or structure.[104] Additionally, the easement must reduce the value of the land by thirty percent.[105]

American Farmland Trust ("AFT") is an example of a private, qualified organization that can hold a conservation easement.[106] Particularly, the AFT looks at Agricultural Conservation Easements ("ACE").[107] The ACE keeps land in farming for the future; ACE is also generally thought of as an estate planning tool,[108] and no prohibitions on its use by a beginning farmer are in place.

In addition, the Farmland Protection Program ("FPP"), available through the National Resource Conservation Service ("NRCS"), provides matching funds to state and private organizations with existing farmland programs to aid in the purchase of conservation easements.[109] The federal share is limited to fifty percent of the appraised fair market value.[110] The farmland must contain fifty per-

---

99. COSGROVE & FREEDGOOD, *supra* note 95, at 28.
100. *See* I.R.C. § 170(h) (2000).
101. *See* I.R.C § 170(h)(1)(A)-(C) (2000).
102. *See* I.R.C. § 170(2)(A)-(C) (2000).
103. I.R.C. § 170(h)(3) (2002).
104. I.R.C. § 170 (h)(4) (2002).
105. COSGROVE & FREEDGOOD, *supra* note 95, at 28.
106. *See generally id.*
107. *Id.* at 21.
108. *Id.*
109. NRCS, USDA, FACT SHEET: FARM BILL 2002: FARM AND RANCH LANDS PROTECTION PROGRAM (Apr. 2003), *available at* http://www.nrcs.usda.gov/programs/farmbill/2002/pdf/FRPPFct.pdf.
110. *Id.*

cent prime, unique, statewide or locally important soil or contain historical value.[111]

In situations in which forested areas are to be purchased, the Forest Service and the NRCS jointly administer the Forest Legacy Program ("FLP"), which can be used to fund a conservation easement.[112] The FLP supports conservation easement acquisition by reimbursing seventy-five percent of expenses, up to $10,000 per landowner, for a minimum of ten years of compliance with sustainable forestry practices.[113] The FSA provides administrative assistance and the USDA Forest Service and State Foresters are responsible for implementing the program.[114]

An alternative to selling an easement to a private organization is to have a beginning farmer donate one to such a group. This provides a charitable deduction to the beginning farmer.

Take this example provided by the California Farmlink:[115] A beginning farm couple identifies a farm for sale for $250,000.[116] With a conservation easement of $75,000 placed on the land ($50,000 provided by government or third party), the farm couple has $25,000 in charitable contribution to recapture over a six-year period.[117] While this example is perhaps a bit extreme in size and the start up costs of a farm may discount the need of a charitable deduction in the beginning years, it may be a viable option for some purchases.

Other conservation programs are available to reduce the cash burden on the beginning farmer after the initial land purchase. The Natural Resources Conservation Service administers a Wetland Reserve Program ("WRP").[118] This program allows landowners to establish conservation easements, on a permanent or periodic basis, for wetlands farmed or farmed wetland pasture.[119] The landowner must have owned the land for at least twelve months prior to enrolling it, unless it was inherited or the NRCS determines that the landowner did not obtain the land

111. *Id.*

112. FOREST SERVICE, USDA, FOREST LEGACY PROGRAM, PROTECTING PRIVATE FOREST LANDS BEING CONVERTED TO NON-FOREST USES, *at* http://www.fs.fed.us/spf/coop/programs/loa/flp.shtml (last visited Nov. 11, 2003).

113. *Id.*

114. *Id.*

115. CALIFORNIA FARMLINK, *supra* note 96.

116. *Id.*

117. *Id.*

118. NRCS, USDA, FACT SHEET: WETLANDS RESERVE PROGRAM (Mar. 2003), *available at* http://www.nrcs.usda.gov/programs/farmbill/2002/pdf/WRPFct.pdf.

119. *Id.* at 4.

for the purpose of enrollment.[120] The NRCS also has programs that fund efforts to conserve private grazing lands, provide wildlife habitat incentives, and environmental quality incentive programs.[121]

Conservation easements may not be feasible for the beginning farmer if he requires the money from the easement as a source of capital for the purchase. The sale of a conservation easement does not appear to be a speedy process.[122] The other potential pitfall of a conservation easement can occur when the sale of the easement is required for purchase. The landowner must give permission for the assessment and surveying of the proposed easement. The landowner may see the potential value of the easement and sell it himself prior to selling the remaining land to the beginning farmer, subject to the newly sold conservation easement.

VII. CLOSING

Tools are available to a beginning farmer to acquire land. Farm land ownership can be obtained via existing government programs. The selection of which tool to apply to what farmland purchase is something that will remain a fact-intensive issue. Hopefully, the tools in the tool box will help connect the next generation of Americans to the land.

VIII. ADDENDUM

One More Tool...Socket Wrench

The 2002 Farm Bill has a pilot program under Section 5006.[123] The "Beginning Farmer and Rancher Contract Land Sales Program" reduces a seller's risk under private contract by guaranteeing up to five private loans per state.[124] This guarantee requires meeting underwriting criteria, and a commercial lending

120. *Id.* at 4.

121. NRCS, USDA, FARM BILL 2002: SUMMARY OF NRCS CONSERVATION PROGRAMS 1-2 (July 2002), *available at* http://www.nrcs.usda.gov/programs/farmbill/2002/pdf/ProgSum.pdf.

122. *See* NRCS, *supra* note 109 (delineating eight steps required to obtain FPP money); Telephone Interview with Anita O'Gara, Program Coordinator, Iowa Natural Heritage Foundation (Oct. 18, 2002) (noting the easement process is often very time-consuming).

123. Farm Security and Rural Investment Act of 2002, 7 U.S.C. § 1922 (2002).

124. *Id.*

institution must serve as the escrow agent.[125] Essentially, the FSA will provide a credit line for the equivalent of two yearly contract payments.[126] This pilot program is currently available only in Indiana, North Dakota, Oregon, Iowa, Pennsylvania, and Wisconsin.[127] This pilot, much like a socket wrench, is a new spin on existing tools.

---

125. *Id.*
126. Dan Looker, *Young Farmers Grow Hope,* SUCCESSFUL FARMING, Aug. 2003, at 13.
127. *Id.*