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## Overview

There are numerous concepts associated with creating an effective lease for a farming operation. A good lease can be a useful tool, but a lease that is inadequate can cause uncertainty and create problems. Also, income tax, social security tax, estate and business planning as well as other economic issues are associated with farm leases.

## Basic Principles

Leasing is of primary importance to agriculture, permitting farmers to operate larger farm businesses with the same amount of capital and assisting beginning farmers in establishing a farming business.<sup>1</sup> Farm leases are conveyances of a possessory interest in property for a specific length of time<sup>2</sup>, but are also contractual obligations which must meet the basic requirements of any contract: offer, acceptance, consideration, and capacity to enter a contract<sup>3</sup>.

- Offer--Party A indicates a willingness to enter into a bargain which leads Party B to believe that Party B's agreement to that bargain is invited and will conclude the bargain.
- Acceptance--Party B indicates agreement to the terms of the bargain in the manner invited or required by the offer.
- Consideration--A bargained for promise, performance, forbearance.
- Capacity--The ability to understand the nature and effects of one's acts. Those with mental illness or defect and minors may void contracts.

## Should a Farm Lease Be in Writing?

Although many farms are leased under oral agreements in Iowa (and an oral farm lease that doesn't exceed one year is enforceable in Iowa) it is preferable to have a written lease. Rather than rely on the selective memories of both parties, a written lease provides a record of the exact terms and conditions agreed to by both the landlord and tenant. In this way, a written lease will clarify the issues if disputes arise between the landlord and tenant.

In Iowa, the statute of frauds requires leases of more than one year to be in writing<sup>4</sup>. This means that for farm leases that are longer than one year, an oral agreement is not valid. However, the principles of partial performance, detrimental reliance and promissory estoppel may be utilized, with the right set of facts, as exceptions to the statute of frauds.<sup>5</sup>

## A Written Farm Lease – Basic Elements

Thus, for many reasons it is just good business for each party to protect their interests with a written lease. The important elements of an agricultural lease are:

1. An accurate description of the land;

**Note:** An accurate legal description can be critical in determining rights to crop proceeds pursuant to security interests and landlord liens and can help avoid legal battles over boundary locations. A precise legal description can be obtained from the

abstract of title to the property. The owner should be able to obtain the abstract for the correct legal description of the farmland. Another method of identification that can be used to supplement the legal description is the farm number used by the USDA for federal farm programs.

2. The identity of the parties and their signatures;

**Note:** Iowa law specifies that the person holding the leasehold interest must produce crops or provide for the care and feeding of livestock, including grazing or feeding of livestock on the land.<sup>6</sup> A lease should include a clear identification of the landlord and the tenant by name and address. It is also appropriate to identify the parties by their tax identification numbers (Social Security number for individuals and federal identification numbers for other entities) for the purpose of eligibility for farm program payments.

3. The length or term of the lease;

**Note:** For most leases, the term will be at least one year. Farm leases usually begin on March 1 and end on the last day of February of the next year. Multiple-year leases may not exceed 20 years.<sup>7</sup> From an economic standpoint, a tenant may prefer a multiple-year lease if they must invest in long-term improvements. Such leases should be considered carefully by both parties because the lease is a contractual obligation to the undesirable provisions of the lease as well as the beneficial ones. Often, it is better to include an automatic renewal clause and a compensation clause as a means of mutual goal evaluation.

4. The kind and amount of rent and time and place of payment;

**Note:** In many farm leases, it may be wise to include a provision that compensates the tenant for the unused portion of longer-term investments.

**Example:** For example, the application of lime and other soil

conditioners may be effective for a period of years. If the tenant applies and pays for the soil conditioner, the lease should provide for a method of calculating payment to the tenant for the unused portion of time the application remains effective.

A written lease containing such a provision will prevent one party from reaping the benefit of the other party's long term investment without compensation.

5. Responsibility for building maintenance;

**Note:** The tenant may want the lease to include a provision specifying that the tenant will be compensated for any improvements the tenant makes to the buildings.

6. Any special provisions concerning the rights and duties of the parties.

It is a good practice to record written leases. After the lease is notarized, it can be recorded, for a fee. If the lease exceeds five years in duration with renewals, Iowa law requires that the lease be recorded.<sup>8</sup> Failure to record these leases within 180 days is punishable by a fine not to exceed \$100 per day for each day of violation.<sup>9</sup>

The increased complexity of farm operations and the conflicts that arise regarding the way they should be operated demonstrates a real need for written farm leases.

**Note:** While many farmers still prefer oral leases and are unwilling to use lawyers, the contracting parties should always consider what the consequences could be if a conflict arises in the future without a written memorial of their agreement.

### Other Legal Issues

**A good husbandry provision.** A written farm lease will often contain a provision requiring the tenant to farm the land in a "good and husbandlike manner." If the tenant fails to do so, the lease typically allows the landlord to enter the property and properly care for the crops and land. "Good

husbandry” is usually defined to include such things as, proper fertilization methods, tilling, weed control, control of soil erosion, manure application, and a general requirement that the tenant protect the property and its natural resources from harm or disposal. A landlord may be entitled to damages that can be proven as a result of the tenant’s use of improper farming methods.

**Note:** Expert advice is available from Iowa State University Extension specialists for help in determining what constitutes proper farming practices.

But, in order to successfully sue for damages allegedly caused by the tenant’s from poor farming practices, the landlord may need to rely on a good husbandry provision in a written lease. While a tenant may have a general duty to use proper farming techniques, the landlord does not necessarily have an associated right to control and supervise the tenant’s farming practices. So, a provision in a written lease detailing the specific farming practices the tenant is to utilize is the best way for a landlord to prevail on a lack of good husbandry claim.<sup>10</sup> In addition, a court may require the landlord to give the tenant notice of the breach and a right to cure before the lease can be terminated.<sup>11</sup>

**Environmental issues.** It may be a good idea to include an environmental-related provision in a farm lease. Such a provision, for example, could include language specifying that: (1) the landlord assures the tenant there are no environmental problems; and (2) the tenant will comply with all applicable environmental laws. In most instances, the tenant will be liable for violation of environmental laws (state and federal) and environmental contamination that occurs during the tenancy. In some instances, however, a landlord could also be held liable.

**The landlord’s lien and security interests.** Under Iowa law a landlord can obtain a statutory lien (claim against the tenant’s property), for the payment of rent, upon all crops grown upon the leased premises as well as the tenant’s other non-exempt personal property which is either used or kept on the leased premises during the term of the lease.<sup>12</sup> The lien is applicable whether the lease is a cash rent lease or a crop-share lease, and applies also to any proceeds of the crop the tenant

harvests.<sup>13</sup> Exempt property includes: specific personal property, life insurance, social security, disability, pension, alimony and veteran’s benefits.

**Note:** If a tenant has more than one lease with a landlord, the landlord may not attach crops from one lease to satisfy a default on rent involving another lease.

Under current law, a landlord’s lien is subject to treatment as an “agricultural lien.” That means a landlord’s lien, to be perfected, must be filed using a financing statement.<sup>14</sup> That’s the same document used by a lender to handle a new secured loan. To be effective, the financing statement must be filed when the tenant takes possession of the leased premises or within 20 days after the tenant takes possession.<sup>15</sup> In addition, the financing statement must include a statement that it is filed for the purpose of perfecting a landlord’s lien. Once a landlord’s lien in farm products is perfected, it has priority over a prior perfected security interest.<sup>16</sup>

**Note:** A purchaser of a farm takes subject to any existing lease, but if the has tenant been in possession for more than 20 days the new owner (as landlord) would take subject to any previously perfected security interests. But, if the new owner files a financing statement, such filing would be sufficient against subsequent lien creditors. Also if the new owner terminates the lease and enters into a new lease, the landlord could get priority over previously filed security interests as for next year’s crop if filing is made within 20 days of the tenant taking possession.

**Lien by contract.** A landlord’s lien can also be created by a language in a written farm lease. Such a provision can create a contractual lien against the lessee’s exempt property that is not subject to the statutory lien. But, for a contractual lien to be valid against third parties, (e.g., subsequent purchasers and existing creditors), the lease must be recorded.

**Security interests.** In some instances, a landlord may want to take the steps necessary to perfect a security interest in the tenant’s crops and/or livestock. Lenders and other creditors file security interests in farm products to ensure payment of debts. From the landlord’s perspective, however, a security interest may provide greater

protection than a landlord's lien, especially if the tenant files bankruptcy.

**Note:** A landlord's lien can be defeated (i.e., goes to the bottom of the list of priorities in the tenant's bankruptcy estate) if the tenant files bankruptcy. Thus, it may be prudent for the landlord to take the necessary steps to gain a security interest in the tenant's crops and/or livestock. That can be accomplished by the landlord making a separate filing to become a secured creditor.

**Additional protection.** For landlords that are concerned about the tenant defaulting on the rent payment, the following suggestions may provide additional protection in addition to those items mentioned above:

- Require the rent to be paid at the beginning of the lease period. If all of the rent is to be paid up front, the rental rate is normally reduced to account for the additional interest accrued due to the early payment;
- Use of an irrevocable letter of credit, issued by the lender on behalf of the tenant, for insuring the payment of rent;
- Have the landlord's name included as the payee on the check for grain and/or livestock. As such, the landlord will be required to sign the check before it can be negotiated.

**Do changes to the lease have to be in writing?**

While it is possible to orally modify a written lease agreement, it's always best to make subsequent changes to a written lease in writing. This leaves little doubt, in the future, about the actual terms of the lease and can help to avoid litigation on the issue.

**Indemnification clauses – liability for negligence.**

Many leases contain an indemnification provision that states the tenant will compensate the landlord any loss resulting from the tenant's negligence (and vice versa). A written contract should give both parties an idea of who will be liable for any accidents which occur on the farm and specify who is responsible for maintaining insurance coverage.

**Does a crop-share lease form a partnership between owner and operator?** The Iowa Supreme

Court has found that, in the absence of evidence indicating otherwise, a traditional farm lease does not constitute a partnership.<sup>17</sup> This is important point. If there is not a partnership, the parties cannot be held liable for the other's debts under the theory of joint and several liability. The elements of a partnership are (1) intent by the parties to associate as partners, (2) a business, (3) earning of profits, and (4) co-ownership of profits, property and control.<sup>18</sup> Most boilerplate lease forms contain a provision stating there is no intention to make a partnership. That keeps the landlord/tenant relationship clear to the parties.

**What other provisions should be included?** The parties should add in writing any additional agreements related to the lease, and should tailor the standard form lease to cover individual requirements for their particular situation. Additional provisions should be included in the space provided at the end of the lease or in attached exhibits that are incorporated into the lease by reference.

In all situations, it is important for both the landlord and the tenant to read and understand the terms of the lease before signing. Consultation with an attorney before executing the lease may be necessary in some instances.

**Easements.** If a third party has an easement interest in the property that is being leased, it is important for the parties to understand the third party's rights and not interfere with them. Certainly, any easement rights should be clearly detailed in the lease agreement.

Most easements are affirmative easements which entitle another party to limited use or enjoyment of the land upon which the easement exists.<sup>19</sup> A common example is the right to use a roadway across another's land. Less common are negative easements, which entitle the owner of the easement to prevent a landowner or tenant from making certain uses of the land. An example might be a negative easement owned by a neighbor which restricts the height of structures built on the farm.

Either the tenant or the landlord could be subject to litigation if a third party's easement rights are interfered with.

**Termination of Farm Leases**

A lease can be terminated either by mutual agreement of the parties (whether via a written lease or oral agreement) or in accordance with the statutory provisions for the service of notice.<sup>20</sup> Under Iowa law, if the lease is not terminated by either of these methods, and involves an acreage of 40 acres or more, the lease automatically renews for another year on the same terms and conditions as the original lease.<sup>21</sup>

**The required notice.** The lease may contain provisions outlining the procedure for termination of the lease. If no such specification is included in the lease agreement, the lease must be terminated according to the provisions of Iowa law. Even if a written lease provides for waiver of termination notice, notice must still be served on the other party (or the party's successor) on or before September 1.<sup>22</sup> If notice is served, the lease terminates the following March 1.<sup>23</sup>

**Note:** If it is mutually acceptable to all parties concerned, after formation of a lease, a lease can be terminated or modified at any time.<sup>24</sup>

Written notice may be given as follows:<sup>25</sup>

- By delivery of the notice on or before September 1, with acceptance of the service to be signed by the party to the lease or a successor of the party receiving the notice.
- By serving the notice, on or before September 1, personally, or if personal service has been tried and cannot be achieved, by publication, on the same conditions and in the same manner as is provided for the service of original notices, except that when the notice is served by publication no affidavit is required. Service by publication is completed on the day of the last publication.
- By mailing the notice before September 1 by certified mail. Notice served by certified mail is made and completed when the notice is enclosed in a sealed envelope, with the proper postage on the envelope, addressed to the

party or a successor of the party at the last known mailing address and deposited in a mail receptacle provided by the United States postal service.

**Forcible Entry and Detainer Actions?** If a farm lease has been properly terminated and the tenant does not vacate the farm by March 1 of the following year, the landlord may utilize the Iowa statutory forcible entry and detainer procedure.<sup>26</sup> Also, a forcible entry and detainer action is also available if the tenant does not pay rent when due, but notice to terminate has not been given. But, before such an action can be brought, notice must be given to the tenant.

**Exceptions to statutory notice.** Iowa law distinguishes between “croppers” and “tenants.” A person is a “cropper” and not a tenant if the landowner supplies the land and the inputs, controls the operation of the farm and pays a portion of the crop to the person raising and harvesting the crop. In that situation, the farmer has no legally enforceable interest in the crop or land involved, only has a contract right for compensation in-kind for their labor, and is basically an employee of the landowner (i.e., a wage earner) that is hired to produce a crop.<sup>27</sup> Therefore, because a cropper does not have any property right in the leased premises, the cropper is not entitled to statutory notice of termination<sup>28</sup> - there is no interest to be terminated. Instead, a cropper's “lease” terminates upon harvest of the crop. However, farmers with crop-share leases are tenants – they are not croppers, and the statutory notice of termination requirement applies.

**Note:** Historically, the statutory notice requirement did not apply to pasture leases. But, that is no longer the rule. Iowa law now defines “farm tenancy” as a leasehold interest in land held by a person who produces crops or provides for the care and feeding of livestock on the land, including by grazing or supplying feed to the livestock.

Another exception from the statutory termination notice requirement is for leases involving less than 40 acres.<sup>29</sup>

These exceptions may be overcome by incorporating a notice requirement into a written lease. Iowa courts also recognize certain legal doctrines which may make notice unnecessary. These doctrines include: (1) agreement; (2) waiver and estoppel; and (3) abandonment and surrender. These doctrines are based on the conduct of the parties.

A landlord can also terminate a lease without giving the statutorily required notice if the tenant breaches the lease – such as for non-payment of rent.<sup>30</sup> Courts require the breach must be positively established. So, it's a good idea for the landlord to notify the tenant of the conduct that is considered a breach, and the landlord's intent to terminate the lease. This may prevent the default termination from looking like an excuse for missing the notice date.

#### **When should termination notice be given?**

Because there may be uncertainty as to a tenant's ability to continue to rent ground because of financial problems, a landlord may want to give notice of termination every year. This will avoid being locked into another year with a questionable tenant. A landlord will then be free to lease to another party or enter into a lease with the current tenant once that tenant can assure the landlord that rents will be paid.

Annual termination may also be advisable when land values are changing rapidly. Cancellation and renegotiation of a new lease with an updated rental amount to reflect current rental values may help the landlord (and/or the tenant) manage risk.

**What is the landlord's right of entry and inspection?** The lease may have a provision allowing the landlord (or someone else) to enter the property after termination of the lease to conduct tilling or fertilization after harvest. The landlord may do this even if the date of entry is prior to the termination of the lease. The landlord may also enter the property at any reasonable time for the purpose of viewing, seeding, preservation of crops, making repairs or for other reasonable purposes.

#### **General Concerns – Economics and Risk Allocation**

**What is the difference between a cash lease and a crop-share lease?** The primary distinction

between a crop-share or cash lease involves how the lease allocates risk between the parties. On that point, here are the major concepts to keep in mind:

1. Cash rent leases allow a farm tenant to pay a specific amount of money for the use of part or all of the described farmland. Cash rent leases will vary in the amount of cash rent per acre and will also vary in the due date for payment of the rent. The tenant may pay a slightly lower rent per acre in exchange for payment of all of the cash rent up front. Typically, the risk is balanced between the parties by having the lease payments paid in installments, one installment in the spring and one or more at harvest. It will benefit both parties to have the times for payment set out in writing so there will be no conflict about when payment is due.
2. Crop-share leases allow the farm tenant to pay shares of the crop as rent. Crop-share leases and cash rent leases can also be combined to utilize both methods of payment. Crop share leases should allow the owner and the tenant/operator to share in the total farm profits in the same proportion as they contribute resources.<sup>31</sup> This principle implies that if a landowner contributes 50 percent of total resources and the tenant contributes 50 percent, then profits should be shared 50/50. Typically, the allocation of government program payments is similar to the allocation of the crop profit and crop input expenses.<sup>32</sup> Due to the fact that the government program payments are often a significant portion of the total return from the farm operation, the lease should determine the agreement of the parties regarding the participation in government programs. Resources and profits are not always shared 50/50. This could be due to high land values or low tenant inputs and costs resulting from practices like minimum tillage and other input differences.

#### **When should a crop-share lease be considered?**

While most farm leases in Iowa are cash leases, there are situations that merit at least a consideration of the utilization of a crop-share lease. The parties should consider the relative advantages and disadvantages of a crop-share lease before executing such an agreement.

Advantages of crop-share agreements:

1. Less operating capital may be tied up by the tenant due to the landowner sharing costs compared to cash rents.
2. Management may be shared between an experienced landowner and tenant, resulting in more effective decisions.
3. Allows an inexperienced landlord or tenant to take advantage of the experience of an established landlord or tenant.
4. Sales of crops may be timed for tax management and purchased inputs may be timed to shift expenses for tax purposes. This is also true to some extent with cash rent leases.
5. Risks due to low yields and/or crop prices are shared between the two parties as well as the profits from high yields or prices.

Disadvantages of crop-share agreements:

1. Landowner income will be variable because of yield and price variation as well as changes in shared input production costs.
2. Accounting for shared expenses must be maintained.
3. Marketing decisions must be made by landowner.
4. The need for tenant and landowner to discuss annual cropping practices and become involved in management on a continuing basis.
5. The lease may need to be reviewed and changed on a yearly basis because of market fluctuations and so on.

**How should the crop be shared between the landowner and tenant?** The crop should be shared on a percentage basis in a manner that recognizes the inputs (capital, labor, etc.) contributed by each respective party. The landlord's return is based on the land value, real estate taxes and insurance costs. If the landlord has a mortgage on the farm, the landlord will want a return sufficient to service the loan. The tenant will expect the rental rate to be within a normal rate of return on land value. The tenant's percentage return is based on his or her labor and management of the farm.

**How should the cost of shared inputs be divided between the landowner and tenant?** A crop-share lease commonly allows yield increasing expenses, such as fertilizer application, to be shared by the

landlord and tenant in the same percentage as the share of crop profits. Sharing a variable cost in the same percentage as the crop is shared encourages the parties to use the amount of that input which maximizes net returns to the total operation.

### **Farm Leases and Farm Program Benefits**

The type of lease can also impact eligibility for farm program payments. In general, to qualify for farm program payments, an individual must be "actively engaged in farming." Each "person" who is actively engaged in farming is eligible for one payment limit of federal farm program payments. A tenant qualifies as actively engaged in farming through the contribution of capital, equipment, active personal labor or active personal management. Likewise, a landlord qualifies as actively engaged in farming by the contribution of the owned land if the rent or income for the operation's use of the land is based on the land's production or the operation's results (not cash rent based on a guaranteed share of the crop). In addition, the landlord's contribution must be "significant," must be "at risk," and must be commensurate with the landlord's share of the profits and losses from the farming operation.

A landlord who cash leases land is considered a landlord under the payment limitation rules and may not be considered actively engaged in farming. In this situation, only the tenant is considered eligible. Under the payment limitation rules, there are technical requirements that restrict the cash-rent tenant's eligibility to receive payments to situations in which the tenant makes a "significant contribution" of (1) active personal labor and capital, land or equipment; or (2) active personal management and equipment.

Leases in which the rental amount fluctuates with price and/or production (so called "flex" leases) can raise a question as to whether or not the lease is really a crop-share lease which thereby entitles the landlord to a proportionate share of the government payments attributable to the leased land. Under Farm Service Agency (FSA) regulations,<sup>33</sup> a lease is a "cash lease" if it provides for only a guaranteed sum certain cash payment, or a fixed quantity of the crop (for example, cash, pounds or bushels per acre.) All other types of leases are share leases. In April 2007, FSA issued a Notice stating that if any portion of the rental payment is based on gross

revenue, the lease is a share lease.<sup>34</sup> However, according to FSA, if a flex or variable lease pegs rental payments to a set amount of production based on future market value that is not associated with the farm's specific production, it's a cash lease.<sup>35</sup>

### **Estate and Business Planning Implications**

While material participation can cause problems with respect to Social Security benefits, material participation is required for five of the last eight years before the earlier of retirement, disability or death if a special use valuation election is going to be made for the agricultural real estate included in the decedent-to-be's estate.<sup>36</sup> The solution, if a family member is present, may be to have a non-retired landlord not materially participate, but rent the elected land to a materially participating family member or to hire a family member as a farm manager. The solution, if a family member is not present, is to have the landlord retire at age 65 or older, materially participate during five of the eight years immediately preceding retirement, and then during retirement rent out the farm on a non-material participation crop-share or livestock-share lease.

### **Tax Considerations**

When considering the type of farm lease to utilize, an issue that is sometimes overlooked is the impact that a particular type of lease will have on estate and business planning goals and objective for the parties involved (particularly for the landlord) as well as the income tax implications of the lease.

**Self-employment tax concerns.** From the landlord's perspective, rents from real estate and from personal property leased with real estate are excluded from the definition of earnings from self-employment. Likewise, income from crop-share and/or livestock-share rental arrangements for landlords who are not materially participating in the farming operation are not classified as self-employment income subject to Social Security tax. Only if the rental income is produced under a cop or livestock-share lease where the individual is materially participating under the lease does the taxpayer generate self-employment income.

Income received under a cash rental arrangement is not subject to self-employment tax, nor does such income count toward eligibility for Social Security

benefits in retirement. An exception to this rule exists if the lessor leases land to an entity in which the lessor is materially participating.<sup>37</sup> IRS has won several cases in which they have successfully attributed the lessor's material participation in the entity to the leasing arrangement with the result that passive cash rent income is transformed into material participation income subject to self-employment tax.<sup>38</sup> But, in the U.S. Circuit Court of Appeals for the Eighth Circuit (which includes Iowa), if the rental income represents a fair market rate, the rental income is not subject to self-employment tax.<sup>39</sup>

The key concept for farm landlords attempting to qualify rental income as self-employment subject to Social Security tax is material participation. Rental income is self-employment income if it results from a material participation lease. If the lease is a material participation lease, the income is subject to SE tax. If it is not such a lease, the income is not subject to the tax. A lease is a material participation lease if (1) it provides for material participation in the production or in the management of the production of agricultural or horticultural produces, *and* (2) there is material participation by the landlord. Both requirements must be satisfied. While not required, a written lease does make a material participation arrangement easier to establish.

Agricultural program payments that are received under a crop-share or livestock-share lease are considered to be SE income for Social Security purposes if the landlord materially participates under the lease.

**Note:** Managing earned income in retirement years can be important, and may have an impact on the leasing arrangement. Persons age 65-70 can receive an unlimited amount of income without loss of Social Security benefits. For persons age 62-65, however, the earnings limit in 2008 is \$13,560. For excess amounts, benefits are reduced \$1 dollar for every \$2 over the limit. Thus, for retired farm landlords under age 65, they may not be able to receive full Social Security benefits if they are materially participating under a lease.

**Income tax considerations.** There are several important income tax concepts to keep in mind when leasing farm land.

**USDA cost sharing payments.** Under certain federal farm programs, especially those programs designed to provide environmental benefits, the USDA shares in part of the expense associated with complying with the program. If certain requirements are satisfied, a farmer that receives cost-share payments can exclude them from income. Crop-share and livestock-share landlords are eligible to exclude cost-share payments from income.

**Soil and water conservation expenses.** Taxpayers engaged in farming can deduct soil and water conservation expenses in the year incurred under a one-time election, rather than capitalizing the expenditures. One of those requirements is that the taxpayer be engaged in the business of farming. A farm operator or landowner receiving rental income under a crop-share or livestock-share lease satisfies the test. But, a landlord collecting rental income on a cash rent basis is not eligible to deduct soil and water conservation expenses on the associated real estate. The landlord must materially participate in the farming operation.

**Fertilizer and lime.** A taxpayer can deduct fertilizer and lime costs by making an election on the tax return, if the taxpayer is in the trade or business of farming. For farm landlords, the lease must be a crop-share or livestock-share lease. A landlord under a cash rent lease cannot deduct the cost of fertilizer and lime. A farm landlord must be materially participating under the lease.

**Interest.** Most farm interest is fully deductible as business interest. Crop-share and livestock-share leases with substantial involvement in decisionmaking by the landlord are deemed to be “businesses” for this purpose.

**Farm income averaging.** Income averaging is available for farmers and fishermen, and allows current farm income to be averaged over three prior base years. The provision is available by election (by filing Schedule J) and provides the benefit of applying lower income tax rates from the prior base years.

**Iowa income tax issues.** Effective January 1, 2007, there is an important provision in Iowa law that is intended to create an incentive for landlords

to lease land to individuals with relatively low net worth.

**“Beginning farmer” tax credit.** Beginning in 2007, a credit against Iowa income tax is available for landlords who lease agricultural assets to a “beginning farmer.”<sup>40</sup> This provision can have the potential to entirely eliminate Iowa tax for individuals that lease farm property to a beginning farmer for several years. Under the provision, the lease must be from two to five years and must be with a tenant who has a net worth of less than \$300,000. It is not necessary that the tenant be a first-time farmer, but the tenant must be at least 18 and can be either a family member or non-family member of the landlord. The amount of tax credit for the landlord depends on the type of the lease. The credit is five percent of the gross amount received under a cash lease, and 15 percent of the gross amount received under a crop or livestock-share lease. If the landlord does not have enough income to fully utilize the credit in any given year, the unused amount can be carried forward for up to five years. The credit cannot be transferred to any other person, but it can be transferred to the taxpayer’s estate or trust upon the taxpayer’s death.<sup>41</sup>

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<sup>1</sup> McEowen & Harl, *Principles of Agricultural Law*, p. 7-6, Agricultural Law Press, Eugene, OR, Rel. 22, Jan. 2008.

<sup>2</sup> *Id.* at 2-3.

<sup>3</sup> *Id.*

<sup>4</sup> Iowa Code §622.32(4). The Iowa statute of frauds is a rule of evidence and not one of substantive law. Thus, the statute provides a defense, and the party asserting it must raise it by answer or by objection to evidence at trial. See, *Harriott v. Tronvold*, 671 N.W.2d 417 (Iowa 2003).

<sup>5</sup> See, e.g., *Kolkman v. Roth*, 656 N.W.2d 148 (Iowa 2003)(where tenant farmer, operating under oral lease and where landlord made assurances that tenant could farm until tenant retired, made substantial improvements to the farm, promissory estoppel available as exception to statute of frauds; farmer submitted substantial evidence of detrimental reliance and established the elements of estoppels; landlord also allowed tenant to make improvements in reliance on oral statements, thus establishing the partial performance exception).

<sup>6</sup> Iowa Code §562.1A.

<sup>7</sup> Iowa Constitution, Article I, §24.

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<sup>8</sup> Iowa Code § 558.44 (In Iowa, recordation is mandatory for any conveyance of leasehold interest in farmland over five years). The lease or conveyance must be recorded no later than 180 days after the conveyance is completed.

<sup>9</sup> *Id.* The tenant is responsible for recording the lease.

<sup>10</sup> *See, e.g.,* Meeker v. Shull, 235 Iowa 701, 17 N.W.2d 514 (1944)(tenant's plowing was excessive and constituted a failure to farm in a good farm-like manner which breached a written lease provision specifically prohibiting tenant from plowing pasture without landlord's consent); McElwee v. DeVault, 255 Iowa 30, 120 N.W.2d 451 (1963)(tenant's omissions contravened express provisions of written farm lease); Thompson v. Mattox, No. 4-511/03-1650, 2005 Iowa App. LEXIS 125 (Iowa Ct. App. Feb. 24, 2005)(while tenant has a duty to use proper farming techniques, landlord has no general right to control and supervise tenant's farming practices absent express provision in written farm lease).

<sup>11</sup> *See, e.g.,* Keller v. Bolding, 2004 N.D. 80, 678 N.W.2d 578 (2004).

<sup>12</sup> Iowa Code §570.1.

<sup>13</sup> Meyer v. Hawkeye Bank & Trust Co., 423 N.W.2d 186 (Iowa 1988).

<sup>14</sup> See Iowa Code §§554.9308(2) and 554.9310.

<sup>15</sup> Iowa Code §570.1(2)(b).

<sup>16</sup> Iowa Code §570.1(2). See also Agriliance, L.L.C. v. Runnells Grain Elevator, Inc., 272 F. Supp. 2d 800 (S.D. Iowa 2003).

<sup>17</sup> Chariton Feed and Grain, Inc. v. Harder, 369 N.W.2d 277 (Iowa 1985).

<sup>18</sup> McEowen and Harl, *Principles of Agricultural Law*, p. 9-13, Agricultural Law Press, Eugene, OR, Rel. 22, Jan. 2008.

<sup>19</sup> McEowen & Harl, *Principles of Agricultural Law*, p. 7-9, Agricultural Law Press, Eugene, OR, Rel. 22, Jan. 2008.

<sup>20</sup> Iowa Code §§ 562.6, 562.7.

<sup>21</sup> Iowa Code §562.6. However, a tenancy will not continue due to lack of termination notice if there is a default in the performance of the existing rental agreement. *Id.*

<sup>22</sup> *See, e.g.,* Schmitz v. Sondag, 334 N.W.2d 362 (Iowa Ct. App. 1983).

<sup>23</sup> Iowa Code §§562.6, 562.7.

<sup>24</sup> Denton v. Moser, 241 N.W.2d 28 (Iowa 1976).

<sup>25</sup> Iowa Code §562.7

<sup>26</sup> Iowa Code §648.1(2).

<sup>27</sup> See Henney v. Lambert, 237 Iowa 146, 21 N.W.2d 301 (1946).

<sup>28</sup> Iowa Code §562.5.

<sup>29</sup> *Id.*

<sup>30</sup> McEowen and Harl, *Principles of Agricultural Law*, p. 7-6, Agricultural Law Press, Eugene, OR, Rel. 22, Jan. 2008.

<sup>31</sup> *Id.* p. 7-6.

<sup>32</sup> *Id.* at 7-7.

<sup>33</sup> 7 C.F.R. §1412.504(a)(2).

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<sup>34</sup> Notice DCP-172 (Apr. 2, 2007).

<sup>35</sup> *Id.*

<sup>36</sup> I.R.C. §2032A. A special use valuation election permits the agricultural real estate contained in a decedent's estate to be valued for federal estate tax purposes at its value for agricultural purposes rather than at fair market value. The election is an important consideration when agricultural land values are rising and the date of death value may cause the estate to incur federal estate taxes. For deaths in 2008, the maximum value reduction that can be achieved by making the election is \$960,000.

<sup>37</sup> Mizell v. Com'r, T.C. Memo. 1995-571.

<sup>38</sup> Bot v. Com'r, T.C. Memo. 1999-256; Hennen v. Com'r, T.C. Memo. 1999-306; McNamara v. Com'r, T.C. Memo. 1999-333.

<sup>39</sup> McNamara v. Com'r, 236 F.3d 410 (8th Cir. 2000).

The IRS has issued a nonacquiescence in the McNamara opinion. AOD CC-2003-003 (Oct. 20, 2003).

<sup>40</sup> Iowa Code §175.37.

<sup>41</sup> For further details concerning the beginning tax credit, see <http://www.calt.istate.edu/beginningtax.htm>.