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SCARIEST THINGS YOU DON'T KNOW: FRIGHTENINGLY COMMON MISTAKES LAWYERS MAKE—AGRICULTURAL LAW

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I. **Impacts of Federal Conservation and Agricultural Programs on Sales and Leases of Farmland.**

The Agricultural Act of 2014 increased the Federal Government's investment in restoring and conserving the Nation's soil, water and wildlife habitat, while consolidating 23 existing conservation programs into 13. These programs are increasingly important to landowners and producers because of the financial and technical assistance they provide, and the owners and producers of the Natural State are no exception. Of the 13 existing programs, the primary ones utilized by Arkansas landowners and producers include: (i) the Conservation Stewardship Program; (ii) the Agricultural Conservation Easement Program; (iii) the Conservation Reserve Program; and (iv) the Environmental Quality Incentives Program. These four programs generally entail a landowner or producer entering into either a multi-year contract with an agency of the United States Department of Agriculture ("USDA"), or granting USDA a multi-year or perpetual easement on certain designated lands. The party entering the contract or granting the easement is generally responsible for implementing specific conservation and/or agricultural practices; however, these contracts and easements typically encumber or "run with" the designated land for the duration of the contract or easement term, regardless of whether the land is subsequently

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conveyed to a third party. Because of the many nuances contained in the Federal Regulations implementing conservation and agricultural programs, an attorney should have a general understanding of these programs, and the limitations and requirements imposed thereunder, before advising a client on aspects of program enrollment and participation, or purchasing or leasing land subject to a program contract or easement. Following is a brief overview of the typical contract/easement requirements and terms applicable to each of the above-referenced programs, as well as some items specific to each program that practitioners should be aware of when advising clients regarding these programs.

1. Conservation Stewardship Program.

The Conservation Stewardship Program ("CSP") is administered by USDA—Natural Resources Conservation Service ("NRCS") and provides financial and technical assistance to eligible producers and landowners to continue or implement certain approved farming or conservation practices on identified lands that result in improved soil, water, air and habitat quality, as well as water quantity. To participate, the landowner/producer must enter into a five year contract with NRCS specifying the approved practices to be continued or implemented by the applicant on the land accepted by NRCS for enrollment. The approved practices vary from area to area, and a list of the approved practices for a certain area can be obtained at the local NRCS office for the county where the land is located. Lands eligible for enrollment include croplands, pasturelands and nonindustrial timberlands; lands enrolled in either the Conservation Reserve Program or Wetlands Reserve Program (now ACEP-WRE) are not eligible for enrollment in CSP. In exchange for continuing or implementing the approved practices—many of which are already utilized by landowners and producers—the applicant will receive annual payments throughout the five-year contract term. The amount of each annual payment is specified in the CSP contract. An individual or legal entity (excluding general partnerships) may receive up to $200,000.00 total under all CSP contracts entered into following enactment of the 2014 Farm Bill.

Note: An applicant is not eligible to receive payments under CSP if the applicant's average adjusted gross income exceeds $900,000.00 for the three year period preceding the year in which payments will be paid.

Note: If the applicant does not own the land offered for enrollment, the applicant must demonstrate to NRCS that it will have "control" over the land for the duration of the contract term. A non-landowner applicant may generally establish control over the land by being certified as the operator of record for the land with USDA-Farm Service Agency ("FSA") and providing NRCS with a lease agreement for the subject land covering the five-year term of the contract.

Note: Federal Regulations require a CSP participant to provide NRCS with written notice of any transfer of control over or ownership of the land subject to a CSP contract, regardless of whether the transfer is voluntary or involuntary. *See* 7 C.F.R. § 1470.25. The time period for providing notice is set forth in the contract and failure to provide timely

notice will result in termination of the contract, in which case the participant may be required to repay any funds received under the contract.

Note: Unless NRCS approves the transfer of a CSP contract, the participant losing control or ownership of all or any portion of the subject land is deemed to be in violation of the contract, permitting NRCS to terminate the contract and require the participant to refund all or a portion of any funds received under the contract. NRCS will generally approve transfers of CSP contracts if: (i) NRCS receives written notice identifying the new producer or landowner who will take control of the land; (ii) the proposed transferee meets the CSP eligibility requirements; (iii) the proposed transferee agrees to assume the rights and responsibilities for the subject land; and (iv) NRCS determines the purposes of the program will continue to be met if the transfer is approved. *See* 7 C.F.R. § 1470.25.

Note: CSP is particularly beneficial to owners and producers of croplands, pasturelands and timberlands not only because of the funds received by participants for performing approved CSP practices, but also because many of the approved practices consist of farming or conservation practices utilized by many landowners and producers. Additionally, CSP practices generally resulted in enhanced value of the land.

Note: Counsel should be mindful of the CSP payment limitation applicable to persons with AGI exceeding $900,000.00 when advising client regarding the sell, purchase or lease of land subject to a CSP contract, as the transfer or lease could result in a violation of the contract terms. *See* CRP Note 6 below.

2. Agricultural Conservation Easement Program.

The Agricultural Conservation Easement Program ("ACEP") was established by Agricultural Act of 2014 to replace the Farm and Ranch Lands Protection Program ("FRPP"), the Grasslands Reserve Program ("GRP") and the Wetlands Reserve Program ("WRP"), all of which were repealed by the Act. NRCS provides financial and technical assistance under ACEP for conserving agricultural lands and wetlands through two components: (i) Agricultural Land Easements and (ii) Wetlands Reserve Easements. NRCS provides assistance to American Indian tribes, state and local governments, and private organizations to protect agricultural lands and limit non-agricultural uses of the land under the Agricultural Land Easements component of ACEP. The Wetlands Reserve Easements component of ACEP ("ACEP-WRE") is utilized by NRCS to restore, protect and enhance wetlands by purchasing conservation easements from private landowners on land offered for enrollment. In Arkansas, Wetlands Reserve Easements are either perpetual in duration or for a term of 30 years. In exchange for a perpetual Easement, NRCS will generally pay a landowner 100.00% of the value of the Easement, and between 75.00% and 100.00% of the restoration costs. For a 30-year Wetlands Reserve Easement, NRCS will generally pay the landowner between 50.00% and 75.00% of the value of the Easement and the restoration costs. Lands eligible for enrollment in ACEP-WRE include cropland, grassland, pastureland and nonindustrial private forest land.

Note: The $900,000.00 AGI limitation applicable to most conservation programs does not apply to payments received under ACEP-WRE, and no cap exists on the amount of funds that may be received by an applicant for enrollment in ACEP-WRE.

Note: Only the record owner of the landmay apply to have it enrolled in ACEP-WRE. Moreover, to be eligible for enrollment, the applicant must have owned the offered land for at least two years prior to submitting an application for enrollment.

Note: A conservation easement granted under ACEP-WRE constitutes a significant encumbrance on the subject land that potential buyers and lessees should be aware of. The terms of the easement generally prohibit any agricultural or development activities on the subject land, including:

(i) haying, mowing or seed harvesting for any reason;
(ii) altering of grasslands, woodland, wildlife habitat or other natural features by burning, digging, plowing, disking, cutting or otherwise destroying vegetative cover;
(iii) harvesting wood products;
(iv) draining, dredging, channeling, filling, leveling, pumping, diking, impounding or related activities;
(v) diverting or causing, or permitting the diversion of, surface or underground water into, within or out of the easement area by any means;
(vi) building or placing, or allowing to be placed, any structures on, under or over the easement area (except structures for undeveloped recreational use);
(vii) planting or harvesting any crop, or grazing or allowing livestock on the easement area;
(viii) disturbing or interfering with the nesting or brood-rearing activities of wildlife (including migratory birds);
(ix) using the easement area for developed recreation (such as camping facilities, recreational vehicle trails, sporting clay or skeet shooting operations and firearm range operations); and
(x) engaging in any activities which adversely impact or degrade wildlife cover or other habitat benefits, water quality benefits or other wetland functions and values of the easement area.

In short, conveyance of the easement is deemed to convey all rights of the landowner in and to the land, except for those specific rights reserved in the easement deed, which generally consist of: (a) the right to enjoy the easement area for undeveloped recreational uses (such as hunting or fishing) and lease such rights for economic gain; (b) the right to prevent trespass and control access by the general public; and (c) the right to convey, transfer and otherwise alienate title to the rights reserved by the landowner.

Note: In addition to the above-listed rights generally reserved to landowners under ACEP-WRE, practitioners should be aware of a few additional rights that can be reserved to the landowner when negotiating the easement terms. In the past, NRCS has shown a

willingness to permit the landowner to reserve other rights, such as minerals rights to the property and the right to manage and selectively harvest timber from the easement area subject to any requirements proscribed by NCRS.

Note: Practitioners advising a client regarding enrollment of lands in ACE-WRE should be mindful of the election provided to enrollees under Section 126 of the Internal Revenue Code to receive all or a portion of the ACEP-WRE payments (as well as payments under certain other conservation programs) tax free. *See* 26 U.S.C. § 126. Section 126(a) states gross income does not include the "excludable portion" of payments received under specified agricultural and conservation programs. Section 126(b) defines the term "excludable portion" to mean "that portion (or all) of a payment made to any person under any program described in subsection (a) which—(A) is determined by the Secretary of Agriculture to be made primarily for the purpose of conserving soil and water resources, protecting or restoring the environment, improving forests, or providing a habitat for wildlife, and (B) is determined by the Secretary of the Treasury or his delegate as not increasing substantially the annual income derived from the property." Pursuant to a Revenue Ruling issued by the Internal Revenue Service in 1997, any cost-sharing payments received by a landowner under the Wetlands Reserve Program (now ACEP-WRE) are excludable from gross income under Section 126. *See* Rev. Rul. 97-55 (IRS RRU), 1997-52 I.R.B. 7, 1997-2 C.B. 20 (1997).

Note: Even if a landowner elects to utilize the gross-income exclusion under Section 126, the ACEP-WRE payment (or portion thereof) excluded from gross income may eventually be subject to taxation. 26 U.S.C. § 1255 contains recapture provisions, whereby all or a portion of the excluded portion of the payments received by a landowner can be recaptured and taxed as ordinary income if the subject property (also referred to as "section 126 property") is disposed of within 20 years of the date the payments were received by the landowners. The amount of payments subject to recapture—also known as the "applicable percentage"—depends on how soon the landowner transfers the property after receiving the payments. Specially, Subsection (a)(3) provides the applicable percentage subject to recapture and ordinary income tax is 100.00%)of the excluded portion of program payments if the property is transferred within 10 years of the date the landowner received the payments. *See* 26 U.S.C. § 1255(a)(3). On the other hand, if the property is transferred more than 10 years, but less than 20 years, after receipt of the program payments, the applicable percentage is reduced by 10.00% each year in years 11 through 20. Once 20 years have passed since the date the payments were received, the landowner may transfer the property without being subject to 26 U.S.C. § 1255's recapture provisions.

3. Conservation Reserve Program.

The Conservation Reserve Program ("CRP") is a land retirement program aimed at temporarily removing environmentally sensitive and highly erodible land from agricultural production. Currently, CRP contracts are for a term of either 10 or 15 years. In exchange for removing identified land from agricultural production, an applicant will receive annual payments

over the duration of the contract, subject to a $50,000.00 annual cap applicable to all CRP contracts to which the applicant is a party. Lands eligible for enrollment in CRP include croplands planted to an agricultural commodity four of the previous six crop years and certain marginal pastureland that is suitable for use as a riparian buffer or similar water-quality enhancement purpose.

<u>**Note:**</u> An applicant may not receive payments under CRP if the applicant's average adjusted gross income for the three year period preceding the year in which payments will be paid exceeds $900,000.00.

<u>**Note:**</u> For an applicant (other than the landowner) to be eligible to participate in CRP, the applicant must have "control" over the land for the duration of the CRP contract <u>and</u> obtain the written consent of the landowner. Further, an applicant must have owned or controlled the property for at least 12 months prior to applying for enrollment.

<u>**Note:**</u> Once the term of the CRP contract expires, the land can be offered for reenrollment in CRP for a similar term or offered for enrollment in ACEP-WRE.

<u>**Note:**</u> Conservation practices and improvements implemented under CRP include establishment of buffers for wildlife habitat and wetlands, riparian buffers, wetland restoration, grass waterways, shelter belts and shallow water areas for wildlife.

<u>**Note:**</u> Any cost-sharing payments received under CRP may be excludable from gross income under 26 U.S.C. § 126. *See* Notes to ACEP-WRE above; *see also* Rev. Rul. 97-55 (IRS RRU), 1997-52 I.R.B. 7, 1997-2 C.B. 20 (1997).

<u>**Note:**</u> The value of CRP land has increased significantly over the past several years. In many cases, the increased value is a result of the enhanced recreational and hunting opportunities provided by the CRP improvements to the land. Because these properties generally do not produce income, other than the payments received throughout the 10 – 15 year CRP contract, potential buyers generally possess sufficient disposable income to close the purchase without financing. When advising such clients on the purchase of lands subject to a CRP contract, counsel should be mindful of the $900,000.00 AGI limitation.

4. Environmental Quality Incentives Program.

Under the Environmental Quality Incentives Program ("<u>EQUIP</u>") an eligible producer or landowner may receive financial and technical assistance for undertaking new conservation management practices pursuant to a Plan of Operation development by NRCS and the applicant or to cover a portion of the costs for installing certain improvements on identified lands to address natural resource concerns and deliver environmental benefits such as improved water and air quality, conserved ground and surface water, reduced soil erosion and sedimentation or improved or created wildlife habitat. EQUIP Contracts may be for a term of up to 10 years. A list of the eligible practices and improvements for specific areas can be obtained at any local NRCS office.

Lands eligible for enrollment include land used for crop production, pasturelands and timberlands; land enrolled in either the Conservation Reserve Program or Wetlands Reserve Program (now ACEP-WRE) are not eligible for enrollment. In exchange for undertaking the conservation management practices or installing conservation-enhancing improvements, the applicant may receive up to $450,000.00 under all EQUIP contracts entered into following enactment of the 2014 Farm Bill.

> **Note:** An applicant may not receive payments under EQUIP if the applicant's average adjusted gross income for the three (3) year period preceding the year in which payments will be paid exceeds $900,000.00.
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> **Note:** For an applicant (other than the landowner) to be eligible to participate in EQUIP, the applicant must have "control" over the land for the duration of the EQUIP contract.
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> **Note:** Federal Regulations applicable to EQUIP require a participant to provide NRCS with written notice of any transfer of control over or ownership of the land subject to a EQUIP contract, regardless of whether the transfer is voluntary or involuntary. *See* 7 C.F.R. § 1466.25. Failure to provide timely notice will result in termination of the contract and result in the participant being required to repay all or a portion of the funds received under the contract.
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> **Note:** Owners of agricultural lands may receive payments under EQUIP for activities such as land leveling, reservoir construction and installation of tail-water recovery systems, which not only enhance the value and productivity of the land, but also the land's habitat for wildlife, such as migratory waterfowl.
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> **Note:** Any cost-sharing payments received under EQUIP may be excludable from gross income under 26 U.S.C. § 126. *See* Notes to ACEP-WRE above; *see also* Rev. Rul. 97-55 (IRS RRU), 1997-52 I.R.B. 7, 1997-2 C.B. 20 (1997).
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> **Note:** EQUIP regulations concerning transfers of control or ownership of EQUIP lands are similar to those for CSP lands. Thus, counsel should be mindful of the CSP payment limitation applicable to persons with AGI exceeding $900,000.00 when advising client regarding the sell, purchase or lease of land subject to a EQUIP contract, as the transfer or lease could result in a violation of the contract terms.

II. Security Interests in Farm Products and Landlord's Lien: Perfection and Priority.

The rules concerning perfection of a security interests in crops and other farm products have varied significantly over the past several years. Before July 1, 2001, security interests in farm products, as well as security interests in farm equipment, were perfected by filing a financing statement in the circuit clerk's office in the county where the debtor is located. *See* Ark. Code Ann. § 4–9–501 (2001). From July 1, 2001 through December 31, 2009, security interests in farm products and equipment were perfected by filing in the circuit clerk's office in the county (or

counties) where the debtor's farm is located. *See* Ark. Code Ann. § 4–9–501(a)(2) (2001); *In re Webb*, 520 B.R. 748, 771-72 (Bankr. E.D. Ark 2014).[2] As of January 1, 2010, however, a financing statement must be filed in the office of the Arkansas Secretary of State to perfect a security interest in farm products or equipment, or an agricultural lien. *See* Ark. Code Ann. § 4–9–501(a) (2010).

An exception to this rule exists for landlord's liens. Pursuant to Ark. Code Ann. § 18-41-101, every landlord is granted a lien on all crops grown on the leased premises to secure payment of the rent due to the landlord for the year in which the crops are grown. The lien is automatically perfected and has priority over conflicting security interests and agricultural liens, regardless of when the conflicting interest or lien was perfected. The landlord's liens continues for six (6) months after the date the rent becomes due and payable, and also applies to "any necessary supplies, either of money, provisions, clothing, stock, or other necessary articles" advanced to the tenant by the landlord in order to enable the tenant to make and gather the crop on the leased premises. *See* Ark. Code Ann. § 18-41-101(b)(2) (2014); Ark. Code Ann. § 18-41-103(a)(1) (2014).

Although Ark. Code Ann. § 18-41-101 states the landlord's lien has priority over conflicting security interests and agricultural liens, the lien is not enforceable against a purchaser of the crops subject to the lien if the purchaser did not have notice of the landlord's lien at the time it purchased the crops from the tenant. See *Riceland Foods, Inc. v. Pearson*, 2009 Ark. 520, 357 S.W.3d 434 (2009). In *Pearson*, the Arkansas Supreme Court held the purchaser of crops does not have an affirmative duty to inquire as to whether the crops are subject to a landlord's lien in every transaction, and "[i]t was only when the surrounding facts put the purchaser on notice that it might be purchasing crops from leased land that a duty arose to make further investigations." 2009 Ark. at *13, 357 S.W.3d at 442-443. The Court ultimately found that, because the purchaser, Riceland Foods, did not have notice that the crops it purchased were subject to a landlord's lien, or facts sufficient to put Riceland on notice that additional investigations should be made, Riceland was an innocent purchaser and took title to the crops free of the landlord's lien. *Id.* at *13, 357 S.W.3d at 443.

Counsel for landlords and agricultural lenders should be particularly mindful of the holding in *Pearson*. Moreover, based on the Court's holding, it appears that simply filing a financing statement may not provide sufficient notice to purchasers, resulting in the purchaser taking title to crops free of a landlord's or lender's interest. Accordingly, despite the perfection and priority of landlord's or lender's interests in crops, additional steps should be taken to ensure that purchasers of the crops subject to a landlord's lien or lender's security interest have notice of the lien or interest. One approach to this issue is to require the producer to certify in the lease or loan documents the specific granaries, mills or gins the crops harvested by the producer will be delivered to, and send each specific granary, mill or gin notice of the landlord's lien or lender's security interest. An example of such notice is attached to these materials as Exhibit A. By providing notice and requesting the purchaser acknowledge its receipt, landlords and agricultural

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[2] This filing requirement continued to be applicable for farm-stored commodities financed by the United States Department of Agriculture–Credit Commodity Corporation through midnight, December 31, 2012. See *In re Webb*, 520 B.R. 748, 771-72 (Bankr. E.D. Ark 2014) (citing Ark. Code Ann. § 4–9–501(a)(2) (2010)).

lenders can help ensure their respective liens will not be subordinated to the interest of a party purchasing the crops.

III. Common Pitfalls to Consider When Drafting Agricultural Lease Agreements.

1. The Lease Term.

Consideration should be given to types of crops that will be grown on the leased premises when setting the lease term. For purposes of determining the term of the lease, crops raised by Arkansas producers fall into two classes: Spring Crops and Fall Crops. Spring Crops, such as cotton, corn, milo, rice and soybeans, are planted during the spring of each crop year and harvested in the fall of the same year, generally between September and November. Fall Crops, such as winter wheat and oats, are planted in the fall of each year and harvested during the late spring/early summer of the following year, usually between May and July. If a lease agreement provides the term of the lease is for a particular crop year, an ambiguity can arise as to whether the lease agreement permits the producer to plant a fall wheat crop to be harvested during the spring/summer of the following year. To avoid confusion, consider adding language to clarify whether the producer may plant a fall crop, such as:

> The term of the lease granted herein shall be for a period of one (1) year (the "Lease Term"), commencing on January 1, 2017, and continuing through the earlier of: (i) the date all crops planted on the Leased Premises during the spring or summer of the 2017 Crop Year have been harvested; or (ii) midnight of December 31, 2018. Producer acknowledges that Producer shall have no right to plant any fall or winter crops on the Leased Premises for harvest in 2018, or file any preventive-planting insurance claim concerning Producer's inability to plant on the Leased Premises any fall or winter crops in 2017 for harvest in 2018, without first entering into a written lease agreement with Landowner for the 2018 Crop Year.

Additionally, consideration should be given to the requirements for enrollment in certain Federal agricultural and conservation programs when determining the term of the lease. Since Direct Payments and Counter-Cyclical Payments were repealed under the Agricultural Act of 2014, many producers are turning to these programs as a means to help supplement their farming income, such as the Conservation Stewardship Program ("CSP") discussed above. Under CSP, an eligible producer and NRCS enter a five (5) year contract under which the producer agrees to continue or implement certain approved farming practices on identified lands that result in improved soil, water, air and habitat quality, and water quantity—many of which are already utilized by producers. In exchange for continuing or implementing these practices, the producer may receive up to $200,000.00 over the duration of the CSP contract. To participate in CSP, a producer must show that it has "control" over the identified lands at the time the application for enrollment is submitted to NRCS. Pursuant to the Federal Regulations, "control" over the identified lands is established by demonstrating to NRCS that (i) the producer is the operator of record with respect to the identified lands according to records maintained by USDA—Farm Service Agency ("FSA"); and (ii) during the term of the CSP contract, the producer will operate

and have effective control of the lands, share in the risk of producing a crop, is entitled to share in the proceeds of the crop, and participates in the daily management, administration, and performance of the farming operation. *See* 7 C.F.R. § 1470.6(a)(1). Thus, because all CSP contracts are for a term of five (5) years, a landowner should consider the potential benefits to not only the landowner and the producer, but also the land itself, by offering a five (5)-year lease arrangement.

2. The Rental Arrangement—Cash Rent, Crop Rent or Both?

Leases for row-crop farmland come in three general varieties: (i) Fixed Cash-Rent Leases; (ii) Fixed Crop-Share Leases; and (iii) Flex Leases, a/k/a "Greater-Than Leases," "Combination Leases" or "Hell-or-High-Water Leases." When advising a client on the type of rental arrangement, special consideration should be given to the effect rental arrangements can have on a landowner's tax liability, the eligibility requirements for participating in Federal agricultural and conservation programs administered by FSA and NRCS, and the payment limitations on payments received for participation in those Federal programs.

With respect to the tax implications of rental arrangements, the rental received may be subject to self-employment taxes, depending on the type of rental arrangement. Cash rent received by a landowner under a fixed-cash lease is generally not subject to self-employment tax. An exception to this rule exists for a landowner that materially participates in an entity that is leasing the farmland from the landowner. In Arkansas (as well as the remainder of the Eighth Circuit), there is an exception to this exception if the amount of cash rent is set at fair market value. See *McNamara v. C.R.I.*, 236 F.3d 410 (8th Cir. 2000). Specifically, the Eighth Circuit Court of Appeal held that cash rent received by a landowner who is a material participant in an entity that is leasing the landowner's land is not subject to self-employment tax if the amount of cash rent due under the lease represents the fair market rental value of the land. *Id.*

On the other hand, rent received by a landowner is the form of a share of the crop produced on the land is subject to self-employment tax if the landowner materially participates or is "actively engaged" in the farming operation. *See* 14 C.F.R. § 1400.207. Pursuant to the Federal Regulations, a person is considered to be "actively engaged" in a farming operation if the person: (1) makes an independent, separate, significant and at-risk contribution to the farming operation of (i) either capital, equipment, land or a combination of the foregoing, and (ii) either active personal labor, active personal management or a combination of the two; and (2) is entitled to receive a share of the farming operation's profits or losses that is proportional to the contribution made by the person (*i.e.*, the person contributes 20% of the contributions to the farming operation and is entitled to receive 20% of the farming operation's profits and losses). 14 C.F.R. § 1400.201. Thus, if a landowner meets the requirements above, the crop rent received by the landowner will be subject to self-employment taxes. Moreover, if the landowner is under age 66 or 67, and is receiving Social Security benefits, the landowner's benefits could be reduced due to the crop rent received by the landowner constituting ordinary income.

The rental received by landowners under a flex lease may or may not be subject to self-employment taxes, depending on the terms of the rental arrangement. The rental terms of flex leases vary significantly. For example, the rental provision may provide that the producer will pay the landowner the greater of a set amount of cash rent per acre or a certain percentage of all crops produced on the landowner's land during the crop year. Another example is a rental provision requiring the producer to pay the landowner the greater of a set amount of cash rent per acre or an amount equal to a set percent of the total gross revenue received by the producer for all crops grown on the landowner's land during the crop year. Lastly, the rent due under another variation of the flex lease may depend on the type of crop, such as a set percentage of all rice grown on the landowner's land and a set amount of cash rent per acre for the portion of the land in which crops other than rice are grown by the producer. Under the Federal Regulations, the question of whether the rent received by a landowner under a flex lease rental arrangement is subject to self-employment taxes essentially depends on whether the landowner is guaranteed a certain amount of rent, regardless of whether the rent is in the form of cash or a share of the crop. *See* 7 C.F.R. § 1400.211 (2016) ("[A] landowner who rents land to a farming operation for cash or a crop share guaranteed as to the amount of the commodity will not be considered to be actively engaged in farming with respect to the farming operation."). Accordingly, the foregoing should be considered when advising a client on the type of rental arrangement to utilize under a lease for farmland.

With respect to the rental arrangements impacts on program eligibility requirements and payment limitations, consideration should be given as to whether the landowner is eligible to receive program payments in the event the landowner is deemed to be actively engaged in the faring operation via the rental arrangement. If a landowner is actively engaged with the producer in the farming operations conducted on the landowner's property, program payments received for these farming operations will be attributable to the landowner and the producer. If, for example, the landowner is ineligible to receive program payments because the landowner's average adjusted gross income exceeds the $900,000.00 limitation, the portion of those payments attributable to the landowner will be forfeited.

3. The Lease Premises—Total or Tillable Acres?

Particular consideration should be given to the description of the leased premises as it applies to the rent due under the lease agreement. All land with a history of crop production has a designated FSA Tract and Farm Number, and each designated Farm and Tract has an established amount of "base acres" or tillable acres. Generally, the base acres of most farms are fewer than the total number of acres comprising the land. The base acres of all farms were established and reallocated pursuant to elections under various versions of the Farm Bill, using the planted and approved prevented-planting history for the land during a specified period and certified by the landowner (or the landowner's representative—*i.e.*, the producer) to the local FSA office via annual reports detailing the use of the farm's acreage.

If a lease for farmland used for crop production provides for a fixed cash-rent or flex rental arrangement, the description of the leased premises will generally determine the amount of rent due to the landowner, and the total amount of rent due to the landowner may vary greatly,

depending on whether total acres or tillable acres are used to calculate the total amount of rent. For example, consider an attorney preparing a lease for farmland used for crop production under which the producer will pay a cash rent equal to $150.00 per acre. If the land contains 500 acres total, but only 415 of the 500 acres are tillable acres, the producer would be obligated to $12,750.00 in rent for acres on which no crops are produced or revenue received. Accordingly, when drafting a lease agreement for farmland used for crop production, counsel should be mindful of the impacts the property description may have on the rental terms. Further, by drafting the lease agreement to expressly address whether cash or flex rent is based on total or tillable acres, counsel can help avoid the potential for disputes between the parties as to the total amount of rent due for the leased premises.

IV. Applicability of Section 18-16-105's Requirements for Terminating Oral Leases for Farmland.

Most practitioners are aware of the unique requirements for terminating oral leases for farmland provided by Arkansas statute. Specially, Arkansas Code Annotated § 18-16-105 provides:

> The owner of farmlands that are rented or leased under an oral rental or lease agreement may elect not to renew the oral rental or lease agreement for the following calendar year by giving written notice by certified mail to the renter or lessee on or before June 30 that the oral rental or lease agreement will not be renewed for the following calendar year.

Thus, this statute applies if a lease is: (i) an oral lease; (ii) for a year-to-year tenancy; and (iii) for farmland. See *Hale v. Ruff*, No. CA98-1373, 1999 WL 436281, *3 (Ark. App. June 23, 1999); Howard Brill & Christian Brill, *Arkansas Law of Damages* § 25:5 (5th ed. 2013). The Arkansas Supreme Court explained that, under the common law, a year-to-year tenant was entitled to six-months' notice to vacate, and by supplying the June 30 date, the General Assembly gave landowners and tenants "a clear, simple and codified method of giving six months' notice as applied to tenancies from year to year." *Seidenstricker Farms v. Warren N. Doss & Etta A. Doss Family Trust*, 372 Ark. 72, 77 (2008). Determining whether the first two elements mentioned above are met should be a fairly straight-forward process—a determination of whether the third element is met, however, may be more problematic.

Section 18-16-105 references only farmland, but does not provide what all land is encompassed within the definition of "farmland." The Arkansas Court of Appeals decision in *Hale v. Ruff*, No. CA98-1373, 1999 WL 436281 (Ark. App. June 23, 1999), is instructive. In that case, the appellate court held that an oral lease of turkey houses was a lease of "farmland," and therefore, § 18-16-105 applied. The court, quoting Black's Law Dictionary, stated "the definition of 'farmer' includes an individual who pursues as a livelihood the production of poultry, and the definition of 'farm' includes land devoted to the raising of poultry." *Id.* at *3. Applying the appellate court's reasoning in *Hale*, it appears a lease concerning pastureland, timberland, fruit and pecan groves, livestock barns or land to be used for production of baitfish, crawfish, vegetables or

fruit, would constitute a lease of farmland. Accordingly, the requirements contained in § 18-16-105 should be observed when terminating a lease for such lands.

EXHIBIT A

[FORM NOTICE]

NOTICE TO BUYER OF SECURITY INTEREST IN FARM PRODUCTS

1. BUYER: **GRAIN BUYER, LLC**
1000 Front Street
Riverside, Arkansas 70001

2. SECURED PARTY: **BILL LANDOWNER**
1000 Easy Street
No-Nonsense, Arkansas 70001

3. **SECURITY INTEREST:** You are hereby notified pursuant to the Federal Food Security Act of 1985 that Bill Landowner (the "Secured Party") holds a security interest in the crops and farm products, as described below. The name and address of the Secured Party are shown above. This Notice is effective for a period of one (1) year from the date of your receipt of this Notice.

4. **DEBTOR INFORMATION:** The name, address and federal tax identification number of the party indebted to the Secured Party is:

Name: John Farmer; Jane Farmer; Farmer Family Farm; Farmer Family Farm Partnership; Farmer Farm; Farmer Family Farm, LLC

Address: 100 CR 505
Farmville, Arkansas 70001

5. **FARM PRODUCTS:** The Secured Party holds a security interest in all of the following described property (the "Farm Products"):

Farm Product	Amount	Crop year(s)	County or Parish
All Crops	$1,000,000.00	2016	Monroe County, Arkansas Prairie County, Arkansas

6. **DESCRIPTION OF PROPERTY:** The following is a reasonable description of the property subject to the Secured Party's security interest:

ALL CORN, COTTON, LONG-GRAIN AND MEDIUM-GRAIN RICE, MILO, SOYBEANS AND WHEAT DELIVERED BY ANY OF THE ABOVE-NAMED DEBTORS IN 2016.

7. **PAYMENT OBLIGATIONS:** The following payments are applicable to this Notice as conditions for waiver or release of the security interest in the Farm Products:

All proceeds are to be paid jointly to Debtor and Secured Party. All proceeds are to be delivered or mailed to Secured Party at the address listed above.

8. **ACKNOWLEDGMENT.** Please acknowledge receipt of this Notice by signing below and returning to the Secured Party at the address shown above. This Notice is dated **January 15, 2016**.

SECURED PARTY:

____
BILL LANDOWNER

ACKNOWLEDGMENT

The undersigned Buyer acknowledges receipt of this Notice to Buyer on this _____ of January, 2016.

BUYER:

GRAIN BUYER, LLC,
an Arkansas limited liability company

By: _________________________________
Name: _______________________________
Title: ________________________________