

## **A Guide To CROP LAND LEASING AGREEMENTS**

### **I. INTRODUCTION**

There are three basic leases: a *crop share lease*, a *cash lease* or a *flexible cash lease*. The lease agreement will state the amount of rent payable, the date of the rental payment, the length of the lease term and the rights and responsibilities of both parties, depending on the type of the lease.

Landowners should consider the tax implication of leasing land. An important tax consideration is the potential loss of the capital gain rollover to a child.

### **A. Considerations**

- Farmers can expand production without financing land purchases;
- Production and marketing risk can be shared;
- Inter-generational farm transfers can be facilitated;
- Suitable land for growing special crops can be acquired;
- Retirement income can be earned on real property while maintaining a
- Increased flexibility in farm planning decisions.
- Rent paid over a long period of time does not contribute to equity of tenant;
- Appreciation in land value goes to the landlord;
- The tenant's security of tenure is limited to the length of the term of lease;
- Long term farming practices which promote production efficiency, soil conservation and improvements may not be practiced in short term leases.

### **B. Features of Successful Lease Agreements**

- The landlord and tenant should be open and honest with each other, and be able to resolve disagreements cordially.
- To maximize long term profit, the terms of the lease should be fair to both the landlord and tenant.
- Written agreements help to prevent conflict between the landlord and tenant, and force them to "think through" an equitable and reasonable lease.
- Leases should be flexible enough to permit fair adjustments to any unexpected situations.
- A lease should be adapted to suit each individual situation, yet remain simple enough to work. The lease period should also be long enough to allow the tenant to adopt good farming practices.

### **C. Tax Considerations in Leasing Land**

- Farmers who rent land to persons other than a spouse or child may not qualify for the capital gain rollover when land is transferred to a child. A custom farming arrangement could be used. Consult a tax professional before taking action in

this area.

- Rental income earned by a landlord can be included as earnings in calculating the maximum allowable RRSP contribution, and in calculating Canada Pension Plan (CPP) contributions. A **bargain purchase option** exercised at a price significantly lower than the fair market value at the end of the lease can create an unexpected tax liability. An accountant or farm management specialist should be consulted before entering into any custom farming arrangement or lease which contains a bargain purchase option.

#### D. Legal Rights in Leasing Land

- A lease is enforceable in court providing a valid contract exists. If the tenant has paid rent, or has done field work on the leased land, a valid contract exists.
- Unless waived in the lease agreement, The Real Property Act gives the tenant the right to have possession of the land without interference from the landowner. The Act also gives the landlord the right to repossess and occupy the property if the tenant has not paid the rent for a period of two months from the due date. Landlords should include a term in the lease agreement which allows them to take specific action to recover the rent, such as seizing and selling grain in the field or in storage.
- To have an enforceable lease against a new owner, a tenant should register a caveat (legal claim) against the land title of the rental property before any change in ownership occurs.
- To be valid and binding on homestead property, The Homestead Act requires that the spouse of a landowner give written consent to any lease agreement. A homestead is any land(s) upon which the husband/wife has lived since marriage in which the husband/wife had an interest (up to a maximum of 320 acres).

## II. SELECTING A LEASE AGREEMENT

Select an appropriate lease arrangement and adapt it to suit your particular situation. In a **crop share lease**, the landlord will receive a share of all crop sales. In a **cash lease**, the tenant will receive the income from all crop sales and will pay the landlord a fixed dollar amount for each year of the agreement. In a **flexible cash lease**, the tenant will receive the income from all crop sales but the dollar amount paid to the landlord for rent varies with the price of the grain.

***Factors other than the rental amount to consider in selecting a lease agreement include:***

- Method and Time of Rental Payment  
Rent due dates and the method of calculating rent depend on the type of lease agreement. In a crop share lease, the landlord will receive the share of the crop sales when the crop is sold. In a cash lease, the rental payment may be paid in

full at the beginning of the season or it may be divided into a spring and fall payment. In a flexible cash lease, part of the rent may be paid in the spring and the balance paid in the fall.

- Length of the Lease  
Crop shares and flexible cash leases often have longer lease terms since they can be extended without renegotiating the rental amount. Cash leases should reflect changes in grain prices.
- Proper Farming Practices  
Leases may contain terms which influence cropping decisions and management practices of a tenant.
- Ease of Rent Calculations  
For crop share leases, accurate records on crop yields and input costs on each field and crop must be kept. Cash and flexible cash leases may be determined annually.

### III. TYPES OF LEASE ARRANGEMENTS

#### A. Crop Share Lease

- The share arrangement could be either the traditional one-third crop share or a crop share based on the cost contributions of the landlord and tenant. The landlord may share in the payment of crop inputs (fertilizer and chemicals) in the same proportion as the crop is shared.
- The crop share lease agreement could clarify and define the landlord's and tenant's rights and responsibilities regarding the following areas:
  - Influence on Cropping Decisions - A landlord may wish to influence the cropping decisions and production practices of a tenant to maintain the quality and condition of the land.
  - Use of Fertilizer and Chemicals - Both parties should agree on the amount of crop inputs to be applied and how the costs are to be shared.
  - Crop Insurance Coverage - Hail insurance can be taken separately by both the tenant and landlord, provided that both have an all risk contract. All risk crop insurance provided by the Manitoba Crop Insurance Corporation is available to any person who is actually engaged in farming in Manitoba, as well as to the landlord who has a direct financial interest in the crop. In order for the landlord to be eligible for Crop Insurance, the payment of rent, as specified in the Crop Share Lease Agreement, must be based entirely on a share or portion of the crop and may not include any "cash per acre", "cash per bushel" or other similar arrangement for payment. If the rent is based on anything other than or in addition to crop share, then the landlord is not eligible for crop insurance.

- Delivery and Sale of Grain - Both parties should agree on who will have the responsibility for delivery and sale of grain.
- Government Payments and Subsidies - Under these programs, usually the producer (tenant) receives the payments and subsidies in the same proportion as the share of the crop (or a stated amount or percentage).

## **B. Cash Lease**

In a cash lease, the tenant will pay a fixed cash payment to the landlord for the use of the land and facilities. The tenant will receive all of the income and pay all his own expenses. The cash lease is suited for absentee landlords and those who wish to have a stable income.

### Considerations:

- The landlord can receive a guaranteed return.
- The tenant has more flexibility and independence in production and management decisions.
- The results of the tenant's superior farming skill are not shared with the landlord.
- Detailed records on crop yields and inputs are not required.
- The tenant assumes all production and marketing risk.
- Part of the rent may be required to be paid in advance of crop sales.
- The landlord has less influence on a tenant's cropping decisions.
- Leases are generally short term due to periodic changes in grain prices.
- The landlord will not immediately feel the effects of extreme fluctuations in yields and prices.
- The cash rental amount can be determined using the income or crop share approach but is usually established by "going rates" in an area. These "going rates" are influenced by land productivity, suitability to certain crops, yield histories and current market prices for the relevant crops, as well as supply and demand for rental land in the community.
- The cash lease agreement should specify the date(s) on which the rent is due and payable; and the rights of the landlord to recover the payment of rent. In addition to the rights provided by The Real Property Act, a landlord should specify the actions he can take to recover the debt, such as seizure of the crop and grain.

## **C. Flexible Cash Lease**

In a flexible cash lease, the rental payment varies each year with the price of grain, thus the risk of any change in grain prices is shared with the landowner. Compared to cash leases, these agreements do not require periodic renegotiation when grain prices change.

### Considerations:

- The tenant has greater independence in decision making than a crop share lease.
  - The risk of changes in grain prices is shared with the landlord.
  - The results of a tenant's superior farming skills are not shared with the landlord.
  - The landlord's rent is guaranteed in relation to quantity, but not to the price of grain.
  - Leases with longer terms can be negotiated, thus encouraging the use of better farming practices.
  - The tenant assumes all risks in crop production.
  - The landlord has less influence on the tenant's management.
- Amount of Rent  
It is important to keep the procedure for calculating flexible cash rent simple. The landlord's share of crop production can be calculated using the crop share approach. The average production for a commonly grown crop will be used as an estimate. This estimate is then adjusted for an allowance for crop failure, and the landlord's share is determined.  
The method for selecting the prices of the commonly grown crops will also be included in the lease, to determine the actual amount of rent due. The rental payment can be made by delivering an agreed quantity of grain to market in the landlord's name or by paying the equivalent cash price.
  - Considerations in Establishing Prices  
The type of grain, grade and the delivery point should be specified if Canadian Wheat Board prices are used. If feed grain prices are used, an average price for 30 days prior to the rent payment should be applied. Alternatively, the price of a specified type and grade of grain on the day payment is made can be used.
  - Flexible Cash Lease Terms  
The flexible cash lease should specify the date(s) on which the rent is due and payable; the delivery point at which prices are to be determined or to which the landlord's quantity of grains to be delivered; and the rights of the landlord to recover the payment of rent (seizure of crop and grain).

#### **D. Custom Farming Arrangements**

Custom farming arrangements provide an alternative to leasing for those landowners who wish to remain classified as a farmer under the Income Tax Act. The arrangement allows a landowner to retain close control of the farm business without becoming actively involved in the operation.

##### Considerations:

- The capital gains rollover provision can be preserved.

- The capital gains exemption on farmland is maintained.
  - Contributions to the Net Income Stabilization Account (NISA) and to the Canada Pension Plan can be made on these earnings.
  - Landowner assumes all risk.
  - All farm operations are arranged by the landowner.
- Types of Agreements
    - Custom Hiring Agreement - The landowner makes all the farming decisions, arranges for the completion of all field operations and pays for all crop inputs. The landowner also receives all the income from grain sales and agrees to pay the custom operator a basic lump sum fee by a specified date, plus a bonus (usually on a crop share or percent profit basis).
    - Joint Farming Venture Agreement - The landowner and custom farm operator are both considered to be farmers. The parties share the crop sales and input costs on a percentage basis (ie 50:50).
    - Farming partnership agreement - the landowner receives all of the income from crop sales and pays a farmer a share (ie two-thirds). The customer operator pays for all of the crop inputs and equipment.
- It is important to consult a lawyer, accountant or farm management specialist before entering into any custom farming agreement. Some agreements may not meet the "income from farming" criteria.

#### IV. STEPS IN COMPLETING A LEASE AGREEMENT

1. Consult with your agricultural representative, regional farm management specialist and lawyer.
2. Study and compare the examples and sample lease agreement forms provided in the "Land Leasing Agreements" publication. It will assist you in determining the type of leasing agreement which will best suit the needs of both the landlord(s) and tenant(s). Remember, the type of lease agreement you choose must be adapted for each individual situation.
3. Determine an equitable "rental arrangement" by first studying the example and then using the worksheet provided for your calculations.
4. READ AND DISCUSS the lease with the prospective landlord(s) and tenant(s) and make changes where desired. Some clauses include a choice of terms. Select the terms that suit your situation. Delete term(s) which do not apply by drawing a line through them and have the parties to the lease initial the deletion(s). If the terms do not suit your situation, write out the terms that meet your particular needs. **Wording is important so it is advisable to consult a lawyer.**

Important terms in all lease agreements requiring careful attention by a landlord and tenant include:

- compensation for repairs to building, fences and improvements
  - rights, responsibilities and compensation for major improvements
  - restrictions and responsibilities regarding production practices and management decisions
  - responsibility for grain storage
  - rights and restrictions of storing grain on leased property at the beginning and end of the lease
  - arbitration
5. The landlord(s) and tenant(s) should each receive one copy of the lease agreement, with any required supplementary forms attached.
  6. Provision should be made on the agreement forms for signatures of joint landlords and tenants.
  7. Ensure that the requirements of The Homestead Act are fulfilled when the leased property is a homestead property.

The Act requires that the spouse give his/her written consent (consent-of-spouse form) to any disposition of a homestead property.

The Act also requires that the spouse appear before a solicitor, notary public, justice of the peace, the registrar of land titles, a local registrar of the Court of Queen's Bench or district court judge to have this form completed. This is to ensure the spouse understands his/her rights in the homestead and that the lease agreement and consent-of-spouse form be signed of his/her own free will without any compulsion on the part of the other spouse.

#### 8. **Complete the Affidavit of Execution**

When all parties have signed a lease agreement, it is final and binding. If the signatures are witnessed and the witness completes the affidavit of execution, it is not necessary at a later date to prove the signatures. (A sample of this form is included in the "Land Leasing Agreements" publication.)

9. Where required, complete the following supplementary forms:

- **Caveat**

A tenant should register a caveat against the land title of the rental property to protect his lease in the event of a change in land ownership.

- **Lease Renewal**

To renew the lease agreement, complete the LEASE RENEWAL FORM, THE HOMESTEAD ACT CONSENT-OF-SPOUSE, CERTIFICATE OF ACKNOWLEDGMENT BY SPOUSE, and the AFFIDAVIT OF EXECUTION.

A CAVEAT must also be completed to have an enforceable lease with a new landowner.

- **Consent to Make Major Improvements**

The tenant should have the landlord complete the CONSENT TO MAKE MAJOR IMPROVEMENTS form in duplicate prior to making major improvements on the rented land. It should be clearly outlined what buildings or improvements are to be made, who will pay the cost of materials, and how the tenant will be compensated for his labour or any costs which he may incur. **Attach one copy of each form to each copy of the lease agreement.**

**Notice to Reader:** This information is general in nature and is intended as a guide only. Interpretation and utilization of this information is the responsibility of the user. No liability for decisions based on this publication is assumed. For application to a specific situation, a professional in the industry should be consulted.