IS YOUR LEASE COMPATIBLE WITH YOUR DIVISION OF USDA FARM PROGRAM PAYMENTS BETWEEN LANDLORD AND TENANT?

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Synopsis: Whether a farm lease meets the technical definition of a “cash” lease or a “share” lease under federal regulations determines whether the farm operator, alone, or both the operator and the landlord is to receive certain USDA farm program payments. “Flexible” or “adjustable” cash rental arrangements, which technically may be “share” leases under the regulations, can be especially problematic. Improper division of farm program payments can result in ineligibility for farm program payments, and in some circumstances, a need to pay back previous payments. If a landlord and tenant have this problem, it may be wise for one to consult with legal counsel before taking further steps.

Whether a farm lease is technically a “cash lease” or a “share lease” under the Code of Federal Regulations (CFR) determines whether “Direct Payments” and “Counter-cyclical Payments” under USDA’s Direct and Counter-cyclical Program must be distributed to (a) just the farm operator or (b) both the operator and landlord. Who can receive these payments is important for several reasons, including USDA farm program payment limitations.

For simplicity, this article will discuss only “Direct Payments” and “Counter-cyclical Payments” but the reader should realize that the technical classification of the lease may also affect how other program payments must be allocated, e.g., Loan Deficiency Payments and payments for ad hoc programs such as the Crop Disaster Program, the Livestock Feed Program, and the Livestock Indemnity Program.

Cash Lease vs. Share Lease: Technical Rules in the Code of Federal Regulations

Technically, for purposes of certain farm program payments, 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).” 7 CFR 1412.504(a)(2). If the farm lease is technically a “cash lease” as just defined, the operator must receive 100% of the Direct and Counter-cyclical Program payments (the landlord is not eligible). 7 CFR 1412.504(a)(5).

For example, a farm lease calling for rent payments fixed at $X per acre or Y bushels of corn per acre, and nothing more, would fall within the technical definition of a “cash lease.” Thus, 100% of the farm program payments must be paid to the operator.

A “share lease” is also defined in the regulations. See 7 CFR 1412.504(a)(3) and 7 CFR 1412.504(a)(4). As a practical matter, a “share lease” (for purposes of program payments) is probably any lease that is not a “cash lease” as previously defined. In a “share lease” situation certain program payments must be divided between the farm operator and the landlord (neither the landlord nor the tenant can receive 100% of the payment). See 7 CFR 1412.504(b).

Failure to pay 100% of the program payments to the operator in a “cash lease” situation, or to divide the payments between the operator and landlord in a “share lease” situation, can result in ineligibility for future farm program payments and trigger a need to pay back past payments. See 7 CFR 1412.604.

The Problem of “Flexible” Cash Rent, Hybrid Leases, and Combination Leases

“Flexible” or “adjustable” cash rent provisions are especially problematic. These provisions may change the character of the lease from “cash” to “share.” This can happen even though the lease has some characteristics of a cash lease, is labeled a CASH LEASE on the lease form, and is viewed as a variant of a cash lease by farm managers. (Note: The terms “hybrid” or “combination” lease may also be used to describe leases incorporating various flexible cash rent arrangements.)

For example, a landlord and tenant honestly may believe they have a cash lease and agree that the operator-tenant should receive all the farm program payments. This “100% to tenant-operator” payment allocation would be required by the federal regulations if the lease in fact met the technical definition of a “cash lease.” However, if the lease stated that the rent is the greater of a fixed sum (the pure cash rent component) or a certain share of the crop, it technically would be a “share lease” requiring a sharing of the program payments between landlord and tenant.
and tenant, even if it were labeled a CASH LEASE. See 7 CFR 1412.504(a)(4).

Similarly, if the lease provided for “flexible” cash rent in the form of a fixed cash rent that would be adjusted upward or downward depending on actual crop yields or a combination of crop yields and crop prices, it might be viewed as a “share lease” under federal regulations. See 7 CFR 1412.504(a)(3).

Under federal regulations it is the technical substance of the lease that determines distribution of program payments, not the label on the lease.

**Looking Ahead: Matching the Lease with the Desired Allocation of Farm Program Payments**

Where existing farm leases are not compatible with the division of farm program payments desired by the landlord and tenant, there is a problem. It may be wise to discuss this problem with legal counsel before taking any other action. Such a discussion could address how much should be said to the Farm Service Agency and what might be left unsaid.

Looking to the future, the landlord and tenant may decide to revise the lease to avoid any future disputes about whether program payment allocations are proper, or they may decide to revise the allocation of farm program payments. The technical lease classification will need to match the division of program payments as prescribed in the Code of Federal Regulations, e.g., 7 CFR 1412.504. See the earlier discussion (Cash Lease vs. Share Lease: Technical Rules in the Code of Federal Regulations.)

**Dealing with the Past: Program Payments Which May Have Been Allocated Incorrectly Because of Confusion about the Correct Lease Classification**

The author understands that once the lease classification (“cash” vs. “share”) and requested program payment allocation are made compatible for future program payments, it is unlikely that past problems will surface unless there is some event that brings the past history to the attention of the Farm Service Agency. Such events might include the dissolution of a farm partnership, a change in the farm operator, or the current operator or landlord unwittingly pointing out the old problem to agency personnel. Once agency personnel are “given notice” of a past problem, even if it resulted from an innocent mistake, they may be required to take follow-up action that could include, for example, a demand that improperly allocated past payments be paid back.

**Summary**

The allocation of certain farm program payments between landlord and tenant must be compatible with the “category” of the farm lease (“cash lease” or “share lease”) as determined by rules set forth in the Code of Federal Regulations. If the farm lease is technically a “cash lease” under federal regulations, the farm operator must receive 100% of the program payments. If the lease is technically a “share lease” under the regulations, payments must be shared between landlord and tenant. Failure to properly allocate payments between the operator and landowner, in light of the lease terms and federal regulations, can make a person ineligible for future farm program payments and trigger a demand that improperly allocated past payments be paid back.

Confusion exists about how “flexible” or “hybrid” or “combination” cash leases affect program payments. Especially problematic are leases that may be labeled a CASH LEASE but are technically “share leases” under federal regulations, or vice-versa.

If the lease and program payment allocations are not in harmony as required by federal regulations, it would be wise to consult with legal counsel as soon as possible. That discussion could address how much should be said to the Farm Service Agency and what might be left unsaid. Corrective action might include revising the lease to avoid future problems and simply providing a copy of the new lease to the FSA office without further comment. For the landlord and tenant, it may be best to focus on the future and not look back at previous program payments that may have been improperly allocated because of confusion regarding the proper technical classification (“cash” or “share”) of the lease.