

# Land Rental Arrangements

(Revised January 2018)



## Foreword

This publication outlines some of the legal and tax considerations of leasing privately owned land. It should not be considered as either an interpretation or complete coverage of the *Income Tax Act* or the various law effecting land rental arrangements. The Government of Saskatchewan assumes no responsibility towards persons using it as such. Relevant Acts and Regulations may change over time. All land rental arrangements should be discussed with a farm management specialist, accountant, tax consultant, and lawyer before they are signed. The Canada Revenue Agency will also provide information.

In addition, this publication provides management information and guidelines for the landlord and tenant when negotiating a rental agreement. The landlord and tenant should study the material carefully and prepare a written agreement that suits their individual situation. The agreement should be reviewed by a lawyer, an accountant and a farm management specialist before completing the final agreement. With longer term agreements both parties should remember that economic conditions are uncertain. For this reason, all essential terms of the agreements should be reviewed on a regular basis to ensure the best determination of current conditions.

Copies of Saskatchewan Agriculture publications are available from the Agriculture Knowledge Centre and Regional Offices. Other publications that will provide information on land rental arrangements are Crop Share Leases, Cash Leases, Flexible Cash Leases and Pasture Leases.

Warning: Landowners who rent land to anyone other than a spouse or child may not qualify for the capital gain rollover, under the *Income Tax Act*, when the land is transferred to a child. Consult a lawyer, accountant or Farm Management Agrologist for specific information.

## Introduction

The large capital investment required in farms today can make renting farm property a good alternative to ownership. The 2016 census indicates that over fifty-nine per cent of Saskatchewan farmers lease at least a portion of their farmland. Thirty-seven per cent of the total farmland is under lease and larger farms rent a larger portion of their land base as compared to smaller farms.

There are both advantages and disadvantages to leasing land.

## Advantages

### (i) Obtaining Capital

Capital investment is shared between two individuals in a land rental arrangement. The landlord supplies land, buildings, and perhaps some of the operating expenses. The tenant supplies labor, machinery, and usually the major portion of the operating expenses. In this way an operator can reach a larger size of business. It is also a means for becoming established in farming. Since leasing is an alternative to ownership, it is really a means of "financing" a land base.

**(ii) Increased Opportunities for Land Purchase**

Lease agreements may lead to an opportunity to purchase the land involved by bringing potential sellers and buyers together. Longer term lease agreements will help establish trust further enhancing the purchase potential.

**(iii) Increasing Efficiency**

When funds are limited it is often more profitable to spend this money on seed, fertilizer, chemicals, and machinery. Investing scarce funds in land may severely restrict the money available for operating capital thus lowering the efficiency of the farm business.

**(iv) Obtaining Farm Experience**

Renting enables the beginning farmer to gain needed experience in the financial operation of a farm business before he commits himself to a long-term investment in land. It also enables the operator to learn more about land in an area and leaves him in a more flexible position to change farms or to leave farming. Renting may enable a younger operator to obtain the managerial assistance of an older experienced landlord.

**(v) Sharing Risk**

By renting, both the landlord and the tenant can share in the risks and uncertainties of farming. This is particularly important to a farmer with limited capital. The extent of the risk-sharing depends upon the nature of the lease agreement.

**(vi) Family Arrangements**

A family business arrangement might include a lease agreement whereby a child rents land from a parent or rents land from a third party and shares the machinery investment with the parent.

**(vii) Providing Retirement Income**

A retiring farmer might consider leasing all or a portion of his land base rather than selling. The ownership of land provides a hedge against inflation since land values tend to increase with inflation and rising grain prices. The income from the rent provides a form of "pension" income to live on during retirement.

A farmer approaching retirement could gradually phase out of farming by renting a portion of his land and farming the rest of it. In this way, his workload is reduced but he still maintains an interest in farming.

**Disadvantages**

**(i) Lack of Security of Tenure**

Short term leases create additional uncertainty and insecurity for the tenant. Machinery size and complement must be matched to the land base. The cancellation of a lease could leave the tenant farmer in a high cost situation.

Short term leases provide more flexibility for landlords since it is possible to change tenants quickly or to sell the land. However, short term leases can work to the detriment of the landlord since it may not encourage superior farming practices by the tenant.

**(ii) Lack of Efficiency, Conservation and Incentive to Make Improvements**

Short term leases may discourage production efficiency. For example, some tenants may not use the optimum amount of fertilizer under a crop share lease unless the landlord shares in the expense of fertilizer.

Most soil conservation practices are of a long run nature. Most tenants with a short term lease are therefore interested only in practices which will show results during the term of the lease. Similarly, improvements of an intermediate or long-run nature (e.g., drainage channel, tree planting, buildings) are not encouraged unless there are provisions for compensation in the agreement.

**(iii) Lack of Credit**

The tenant farmer usually has a more difficult time to obtain intermediate and long term credit than does the owner- operator. The three major reasons for this are: the lender may require land as security for the loan; leased land does not build equity; and the lease is short term. The tenant should have no greater difficulty than the owner- operator in obtaining operating and intermediate term credit.

**(iv) Lack of Bargaining Power and Managerial Control**

There may be situations where the landlord has greater bargaining power even though the tenant is a capable manager. The landlord may insist on making most of the management decisions even though his contributions to the lease may be substantially less than the tenant's contribution. For example, the landlord may insist on certain crops being grown which are not the most profitable as far as the tenant is concerned.

**(v) Lost Opportunity for Capital Gain**

Land prices have generally increased over time although they do decline occasionally. Land appreciation is an added benefit to the landowner even though the capital gain is not realized until the property is sold.

**(vi) People Problems**

As with any business venture involving two or more persons, disputes and disagreements can arise.

**(vii) Potential Loss of Capital Gain Rollover**

Land leased to anyone other than a spouse or child or to a spouse's or child's family farm corporation or partnership means that a taxpayer does not qualify for the capital gain rollover when the land is transferred to a child. However, the land owner may be eligible to use the Lifetime Capital Gains Exemption, if the land meets the "qualified farm property" criteria. There is no Capital Gains Exemption for non-qualifying real estate. This would include land which is leased and is not "qualified farm property."

Most of the disadvantages outlined above can be reduced or eliminated by meeting the basic general requirements of any lease arrangement.

## **Requirements for a Successful Lease**

### **Compatibility and Honesty**

The most important aspect of any lease arrangement is that the landlord and tenant are able to get along together and resolve quickly any disagreements that may arise. Even under the most compatible situations between a landlord and tenant, there are times when they may not be able to agree. Provisions should be made in the written lease agreement for arbitration of differences by a third party whenever the occasion demands a settlement.

It is very important that the individuals are honest. The landlord in a crop share leasing arrangement should be particularly concerned about the integrity of the tenant since he depends on the tenant to give him the specified share of crop or the cash rent due.

### **Equitable Terms**

Most tenants and landlords want to receive a reasonable return from the lease. If one party feels that his return is unsatisfactory, then it jeopardizes the chance of the lease continuing.

### **Written Agreement**

A written agreement is preferable so that each party knows what is expected. This will not only prevent misunderstanding, but it will encourage both the tenant and landlord to "think through" an equitable and reasonable lease. Each party knows, from the written lease, what their rights and responsibilities are.

Verbal agreements may be binding but they do not document all of the details and terms required or agreed upon. This may result in unnecessary future disputes when memories of the original verbal agreement differ.

### **Flexibility**

In entering into a lease agreement it should be recognized that interests, ambitions and requirements of people change over time. Economic and social conditions also change. Enough flexibility should be included in the written agreement to permit an equitable adjustment to unexpected situations that may appear.

### **Suitability**

The arrangement must fit the needs of the individual situation. The lease should be of sufficient duration to permit relatively long-run production practices on the farm. A longer term lease will give the tenant more security and encourage him to use good management practices. The lease arrangement should also be simple enough so that it is workable.

### **Important Terms of Lease Agreements**

A satisfactory lease is one which contains adequate provisions for governing the rental arrangement and is agreed to by a landlord and tenant. Lease agreements should include all the important terms and be in a written form. A written lease serves as a reference in case of disputes and assists in reaching a clear understanding. All leases should contain the following:

### **Names and Addresses of Tenant and Landlord Description of Property to Be Rented**

The agreement must specify the common legal description of the rented land (e.g., NW 16-17-19-W3). Certain areas or permanent buildings to be excluded must be specified. For example, the landlord may wish to exclude the farm house and continue residing on the premises.

### **Length of the Lease**

The agreement must state the duration of the lease including the time it commences and terminates. Longer term leases are desirable since they reduce the uncertainty and insecurity experienced by the tenant and encourage him to farm the land properly. Since economic conditions may change, agreements in excess of three years should provide for a periodic review of the essential terms.

### **Amount and Payment of Rent**

The rent payable for leased land is usually a share of crop or cash rent. Negotiation and agreement are the final determinants of the amount of rent. The contributions approach can be used to test the fairness of the rental arrangement. The rent and payment schedule must be stated in the written agreement.

### **Responsibility of Taxes**

Unless specified otherwise in the written agreement, taxes are the responsibility of the landlord.

### **Compensation for Repairs to Buildings, Fences, and Improvements**

The written agreement should state who is responsible for repairing buildings, fences, and other improvements, and how the expenses will be shared. A common practice is to have the tenant responsible for all minor repairs and for the landlord to reimburse the tenant for improvement costs which have a lasting benefit longer than the rental term.

### **Rights, Responsibilities, and Compensation for Major Improvements**

Provisions should be made in the lease to compensate the tenant for major improvements which extend beyond the length of, or termination of, the lease. Major improvements include building and fence construction, erosion control, water development, and clearing and breaking. It is usually required that the tenant obtain written permission from the landlord before making major improvements. It is also important to outline how the value of improvements will be determined and when compensation will be made. A tenant will sometimes do clearing and breaking on leased land. In order to reimburse the tenant for the improvement, the landlord may let the tenant farm the improved land rent free for a number of years.

The number of years of free rent should relate to the fair market value of the improvement made by the tenant, interest rates and the normal rent that would be obtained by the landlord.

To determine the number of years of free rent for the tenant the value of the improvement could be considered like a loan. By using amortization tables, after the interest rate and value of rent have been determined, the number of rent free years can be determined. For example, if the value of the land improvement was \$100.00 per acre, the interest rate was 10% and the normal rent on the improved land was \$20.00/acre, the resulting

term would be 7 years. (The amortization factor to pay off \$1.00 at 10% over 7 years is .2054; therefore it would take approximately \$20.54 per acre to pay off \$100.00 in 7 years.)

Another method of visualizing this calculation is as follows, assuming land improvements of \$200 per acre, an interest rate of 5% and a normal rent on the improved land at \$50.00 per acre. Therefore, it would take 4 years to pay off the \$200 and on the 5<sup>th</sup> year rent would be \$21 or in Year 4 the rent would revert to \$50.00 per acre.

Year 1 = \$200 x 1.05 = \$210 - \$50 = \$160  
Year 2 = \$160 x 1.05 = \$168 - \$50 = \$118  
Year 3 = \$118 x 1.05 = \$124 - \$50 = \$ 74  
Year 4 = \$ 74 x 1.05 = \$ 78 - \$50 = \$ 28  
Year 5 = \$ 28 x 1.05 = \$ 29 - \$50 = \$ (21)

### **Rights to Assign or Sublet the Lease**

The written agreement could contain a clause which prevents the tenant from subletting or assigning the lease to another individual without the written consent of the landlord.

### **Production Practices and Management Decisions**

The written agreement should specify those production and management decisions which the landlord insists are carried out by the tenant.

### **Other Requirements**

The following factors should also be considered in drawing up a crop share agreement:

- cropping decisions
- use of fertilizer and chemicals
- crop insurance and Agristability
- delivery and sale of grain

### **Responsibility for Grain Storage**

The written agreement should outline the minimum amount of grain storage, if any, to be provided by the landlord. If additional grain storage is required it is usually provided by the tenant.

### **Grain Stored on Land at Commencement and Termination of Lease**

The written agreement should specify how long undelivered grain can be stored on the rented land without storage charges.

### **Right of Entry**

The landlord or a representative of the landlord should have the right at all times to inspect the rented property and remove any grain stored on the land which he wasn't able to sell at the commencement of the lease. Similarly, the tenant should be able to remove his share of grain stored on the rented land or complete harvesting of the crop after termination of the lease agreement. *The Agricultural Leasehold Act* protects the tenant's interests.

An incoming tenant, purchaser or landlord should have the right to enter on the land after harvest in the last year of the agreement to prepare the land for next year's crop.

### **Arbitration**

It is considered desirable to include an arbitration clause in the written agreement. Any disagreement which might arise and which cannot be resolved between the landlord and tenant would by mutual agreement be referred to a third party who would act as an arbitrator. This approach is usually preferable to a court case which can be very costly.

### **Option to Buy**

The landlord may give the tenant an option to buy the land under lease at some time during or at the end of the lease. Another alternative is a "Right of First Refusal" whereby, should the landlord ever wish to sell the land; the tenant is given the right to buy the land at the same terms and conditions offered by another purchaser.

### **Compensation for Property Damages**

The party who has suffered any loss should receive any compensation payable. For example, if a payment is made as a result of crop damage, the tenant should receive the entire compensation in the case of **cash rent**, but the compensation should be shared in the same portion as the crop is shared in a **crop share rent**. In the case of capital damage to land, the landowner should receive the entire compensation.

### **Income Support Payments, Subsidies and Reimbursements**

The written agreement should clearly specify how payments, subsidies, or other reimbursements made under any government agency in connection with **income support** to the actual producer of crops grown on the leased land are handled. Normally the terms are different for a crop share lease versus a cash lease.

For crop share leases, income support payments, subsidies and reimbursements for which no contributions are required and which relate to income support to the actual producer of the crops grown on the leased land, should be shared by the tenant and landlord in the same proportion as the crop share ratio. When contributions are required to qualify for an income support payment, subsidy or reimbursement, the entitlement should be shared in the same proportion as the landlord and tenant pay the contributions. If the tenant pays all contributions, then he should receive all entitlements.

For cash leases and flexible cash leases it is normal for the tenant to receive full entitlements to income support payments, subsidies and reimbursements. Tenants will normally pay a cash rental which reflects all expected sources of income from the rented land (crop income plus income support). Therefore, income support payments, subsidies and reimbursements are not shared.

### **Miscellaneous**

The parties to the lease agreement may write into the lease a clause which would terminate the lease if certain natural disasters occurred. For example, if the land was flooded and the tenant was unable to use the property, it would be unfair to insist that the tenant continue to pay the cash rental unless the level of rent agreed to have taken into account the risk of flooding.

Other unforeseen circumstances include the installation of a highway, gas line, oil well sites, etc. on the rented land thus creating inconvenience and additional operating costs for the tenant. In some instances it may be considered desirable to renegotiate the terms of the lease or compensate the tenant for the added costs or reduced income which they may incur.

**Land Leasing Arrangements and Risk**

The three most common land leasing arrangements on crop land are the **Crop Share, the Cash Rent and the Flexible Cash Rent.**

In all three types the landlord provides the land, pays the property taxes and may supply some or all the grain storage. The tenant pays the operating expenses, and supplies labor and machinery to farm the land.

The division of income varies with the type of leasing arrangement. In the case of the **Crop Share** recent common division has been at 25% - 75% or 20% - 80% (Landlord/Tenant) ratios when there are no input costs paid by the landlord.

When input costs are shared, there used to be a 33.3% share of all crop sales to the landlord and 66.7% share to the tenant ratio used; however, that is really more closely related to past, traditional agreements rather than purely economic considerations. A landlord able to negotiate this arrangement should know they are getting a very good deal. The income is divided as the grain is sold.

For **Cash Rental** arrangements the tenant receives the income from all crop sales but pays the landlord a fixed dollar amount each year as the rent.

In the case of the **Flexible Cash Rent**, the tenant receives all the income from crop sales but the dollar amount paid to the landlord each year varies with either the price of grain or yield of grain, or both price and yield. The Flexible Cash Rent incorporates features of both the Crop Share and Cash Rent leases.

The amount of risk that is borne by the tenant and landlord depends on the type of leasing arrangement. Two types of risk that occur in land leasing arrangements are marketing risk and production risk. With marketing risk, income is affected by price variations, crops grown, delivery opportunities and storage costs and losses. In the case of production risk, income is affected by the crop yields due to weather, insects, disease, use of inputs and general management.

Since the return on an investment should relate to the amount of risk assumed, in the long run one should expect that a landlord would receive a higher total rent from Crop Share Leases, lower rent on a Cash Rental and medium rent for a Flexible Cash Lease.

**Table 1: Landlord's Risk for Leasing Arrangements**

Type of Lease	Production Risk	Marketing Risk
Crop Share Lease	Yes	Yes
Flexible Cash Lease	Yes	Yes
Cash Lease	No	No



## **Establishing a Rental Rate**

Rental rates are largely established by market forces, that is, the supply of and demand for rental land in a district. Landlords and tenants through a process of negotiation and bargaining establish rental rates and conditions of a lease. Tradition has an influence on rents, particularly for crop share leases.

A significant amount of land is rented within families. True market forces may not always apply in these situations.

Prior to entering into a lease, both parties should carefully prepare financial projections. The financial projections should estimate the amount of dollar returns that can be expected.

Often tenants must pay the going rental rate in an area (market rate) or they will not obtain a lease. The tenant should make financial projections to determine if the income from the leased land will adequately cover the costs and return a reasonable amount for his labour and machinery inputs.

Land rental auctions have also been used to help establish market value cash lease rates where interested parties may participate in the bidding process either in-person or on-line.

Landlord's should calculate how much return can be expected on their land investment.

For family situations, the tenant and landlord should sit down together and calculate their respective returns to determine if the arrangement is fair.

Types of financial planning techniques that are useful to determine rental rates are as follows:

### **(i) Contribution Approach**

The contributions approach is a budgeting method that can be used to test the fairness of a lease arrangement. This approach simply means that "each party to an arrangement should share the income from the land in the same proportion as they contribute to the costs."

Other things being equal, a tenant should receive a larger share if he contributes more in the way of crop inputs, machinery, labour or accepts a larger risk. By the same token, a landlord should receive a larger rent for more productive, and higher valued land.

### **(ii) Income Approach**

The income and expenses for the given situation are estimated. The return above expenses is the net income. A tenant or a landlord can make a decision based on a return to labour or investment.

Tenants can use the income approach to determine how much rent they can afford to pay a landlord.

### **(iii) Cost Approach**

Landlords can use the cost approach to determine how much cash rental is necessary to result in the desired rate of return on the land investment.

**(iv) Crop Share Equivalent Approach**

This approach can be used to establish a cash rental rate. The landlord estimates the amount of rent he would receive based on a normal crop share lease. This amount is then used as the basis for establishing or negotiating cash rent.

**(v) Market Approach**

The going rental rate and conditions in the area establishes the rent for the land in question. When the market determines the rental rate, each party should do their own financial projections to determine if the returns will be adequate to make the leasing of the land worthwhile.

The financial planning techniques are discussed in greater detail in the sections on crop share, cash rent and flexible cash lease agreements.

**Cost Guidelines**

Use realistic estimates of costs when doing financial planning for leases. Costs may include depreciation, interest on investment, cash operating expenses and labour and management.

Past accounting records provide excellent guidelines for certain costs. Other sources include published reports on production costs.

In estimating an investment allowance for land, consideration must be given to the fact that land normally commands two types of earnings; annual earnings amount (rent) and long term appreciation in value (capital gain). The rental earnings plus the capital gains earnings are the total return on land investment.

The earnings from land are similar to earnings from a stock which includes dividends plus capital gains. In contrast, interest is the only form of earnings from a term deposit or guaranteed investment certificate.

For these reasons a five per cent annual interest on investment allowance has been used in the examples in this publication with the balance of the earnings coming from anticipated capital gains

**Crop Share Leases**

At one time, the crop-share lease was the predominant method of leasing crop land in Saskatchewan. That is no longer the case as cash lease agreements have overtaken that method in more recent years. In a historical 33.3% - 66.7% crop share lease, the landlord received a 33.3% share of all crops grown on the leased land. The landlord paid the property taxes and supplied grain storage. The tenant received a 66.7% share of the crop and supplied all the machinery, labor and crop inputs. However, more recently a typical crop share lease agreement is usually closer to a 20% - 80% or 25% – 75% (Landlord/Tenant) share ratio.

With today's agricultural technology there are many variations to the standard crop share lease. Current crop share agreements range significantly depending upon what, if any, input costs are shared by the landlord. The landlord and tenant usually share some costs such as fertilizer and chemicals in the same proportion that the crop is shared. Occasionally a landlord may supply machinery with the lease or pay part or all of the seed costs.

There are several advantages and disadvantages to Crop Share Leases. These are:

**Advantages**

- The landlord and tenant share the risks associated with grain prices and yields in the same proportion as the share of crop.
- The rent varies directly with the value of production and is paid as the crop is sold, rather than in advance.
- The landlord may pay part of the crop inputs such as fertilizer and chemicals.
- An inexperienced tenant may be able to utilize the management expertise of a landlord with farming experience.
- A landlord will make more money in the long run on a crop share arrangement compared to other arrangements providing that the tenant is a good manager.
- The income received from a crop share agreement by the landlord is eligible for AgrilInvest.

**Disadvantages**

- The results of a tenant's superior management are shared with the landlord.
- The landlord may wish to influence decisions on the leased land.
- The landlord will make less money on a crop share arrangement compared to other arrangements if the tenant is a poor manager.
- There is more administration and more issues on a crop share arrangement than other rental arrangements. (Production, cash advances, feed fed to livestock.) This quickly becomes even more complex when multiple landlords and lease agreements are in play.
- The integrity of the tenant is very important to the landlord.

**The Amount of Crop Share Rentals**

Negotiating ability and the landlord's and tenant's expectations are the final determinants of how a crop is divided between a landlord and tenant. Financial planning by the landlord and tenant, either jointly or independently, is important to ensure that the amount of rent will meet both the landlord's and tenant's expectations and will provide a basis for a successful rental agreement. Several budgeting techniques are illustrated in the following.

<b>Table 2: The Contribution Approach (Dark Brown Soil Zone)</b>		
<ul style="list-style-type: none"> <li>• Tenant pays all operating costs, supplies, machinery and labour</li> <li>• Landlord supplies grain storage (at new cost)</li> <li>• Land valued at \$1464 per acre</li> <li>• 3 yr. continuous crop rotation (spring wheat, canola, green peas)</li> <li>• Dark Brown Soil Zone</li> </ul>		
<b>Landlord's Costs Per Cultivated Acre</b>		
Investment Cost	\$1464 x 5%	\$73.20
Property Taxes		\$6.16
Grain Storage (Based @\$125 per acre)		
(a) Depreciation	$(\$125 - \$12.50) \div 30$	3.75
(b) Interest	$(\$125 + \$12.50) \div 2 \times 8\%$	5.50
(c) Repairs	\$125 x 1%	1.25
<b>Total Landlord's Costs (A)</b>		<b>\$89.86</b>
<b>Tenant's Costs Per Cultivated Acre</b>		
Seed		\$41.77
Fertilizer and Chemicals		\$137.00
Machinery: Fuel, Oil and Repairs		\$20.54
Miscellaneous Costs		\$18.19
<b>Total Cash Costs</b>		<b>\$217.50</b>
<b>Labour Allowance</b>		<b>\$17.08</b>
Fixed Costs:	Interest on Machinery	\$19.09
	Depreciation on Machinery	\$31.42
<b>Total Fixed Costs</b>		<b>\$50.51</b>
<b>Total Tenant's Costs (B)</b>		<b>\$285.09</b>
<b>Total Landlord's and Tenant's Cost (A+B) = \$374.95</b>		
Landlord's Share of Total Costs: $\$89.86 / \$374.95 \times 100\% = 24\%$		
Tenant's Share of Total Costs: $\$285.09 / \$374.95 \times 100\% = 76\%$		

### **(i) Contributions Approach for Share Rentals**

Table 2 (prior page) provides an example of how to determine the share of crop using the contributions approach.

The contributions approach utilizes estimated costs of the tenant and landlord to determine the crop share ratio. This approach can be used by a tenant or landlord independently to determine what would be a reasonable crop share ratio and then used as background information to negotiate an agreement.

It could also be used by a landlord and tenant to estimate costs and thereby establish the share ratio. This is most often used in family leasing situations.

The contributions approach can also be used to estimate what would be a reasonable change in a crop share ratio for changes in costs incurred by each party. It could be used to answer questions such as:

"If the landlord pays 33.3% of the fertilizer and chemical costs, what would be a reasonable crop share ratio?"

"If the landlord supplies some machinery, what would be a reasonable crop share ratio?"

"If the tenant follows a continuous cropping rotation, what would be a reasonable crop share ratio?"

The calculations in Table 2 result in a crop share ratio of 24% for the landlord and 76% for the tenant. The results should be considered as a guideline only. Numbers used in the example mostly come from the Ministry's Crop Planning Guide 2017 and may not be representative of individual needs. Estimates used are explained in the guide or in the table above. For example, land investment will vary with the market value of land and the earnings rate selected. All estimates are similarly difficult to determine and can vary greatly from situation to situation.

### **a) Sharing Crop Input Costs**

A landlord may agree to share the cost of fertilizer and chemical in the same proportion as the crop share ratio. Landlords often recognize the income increasing effect of such inputs and agree to share the costs as a means of ensuring optimum yields.

The contributions approach in the previous example can be used to illustrate the calculated crop share where two parties agree to share the fertilizer and chemical costs. The fertilizer and chemical costs of \$137.00 per acre can be excluded from the tenant's cost schedule resulting in revised total tenant's costs of \$148.09 per acre. The landlord's costs remain the same at \$89.86 per acre. The relative cost contributions are now 37.8 per cent for the landlord and 62.2 per cent for the tenant. ( $\$89.86 \text{ Landlord} + \$148.09 \text{ Tenant} = \$237.95 \text{ Total}$ )

If a 37.8% - 62.2% crop share ratio was agreed to in this example, then the fertilizer and chemical costs would be shared on the same percentage basis as well.

With longer crop rotations, high cost specialty crops, and continuous cropping, crop input costs, machinery investments and labour inputs will be higher for the tenant as compared to shorter crop rotations. Longer crop rotations should provide a larger share of the crop to the tenant.

### **b) Crop Share Rental Arrangements with Machinery Included**

Generally the inclusion of machinery in a land rental arrangement is not recommended, however, it can be

justified on a short term basis in some circumstances. For example, the landlord may not be able to find a tenant with sufficient machinery to farm the rental property. Perhaps the landlord decides to rent the property for a year or two but is uncertain if it will be permanent. In these circumstances it may be wise for the landlord to retain the ownership of machinery.

**When a farmer ceases farming and rents his land but retains ownership of his machinery, he is not permitted under the *Income Tax Act* to claim capital cost allowance on the machinery unless it is included in a lease.**

Including machinery in a land rental agreement has potential problems. The landlord could lose financially if the tenant abuses the machinery through reckless handling and improper servicing or maintenance. The landlord should assess the tenant's farming practices carefully. The written agreement should specify who is responsible for minor and major repairs. If the tenant is responsible for all repairs, it puts the onus on him to operate and service the equipment properly. This could be a disadvantage to the tenant if the equipment is old and the landlord is reluctant to replace it with newer machines. Major repairs (e.g., motor overhaul, replacement of tires) would likely be the responsibility of the landlord providing the tenant has not been negligent. The share of crop or cash rental based on the contributions approach could vary considerably as very old machinery is replaced with new machinery. For this reason it may be necessary to recalculate the cost contributions for years when the old machinery and equipment are replaced with new implements.

The example in Table 3 illustrates how to determine the share of crop using the contributions approach when machinery is included in the agreement.

<b>Table 3: Crop Share Rental Arrangements with Machinery Included</b>			
Assumptions: Land is valued at \$1464.00 per acre. (Dark Brown Soil Zone)			
The tenant pays for all fuel, oil and minor repairs, fertilizer and chemicals.			
<b>Landlord's Costs Per Cultivated Acre</b>		<b>Tenant's Costs Per Cultivated Acre</b>	
Investment Cost = $\$1464 \times 5\% =$	\$73.20	Seed	\$41.77
Taxes	6.16	Fertilizer and Chemicals	137.00
Grain Storage	10.50	Miscellaneous Costs	18.19
Machinery Repairs (major)	7.60	Machinery Fuel, oil, repairs	12.94
Machinery Investment	19.09	Labor	17.08
Depreciation	31.42	<b>TOTAL</b>	\$226.98
<b>TOTAL</b>	\$147.97		
Total Costs Landlord and Tenant = \$374.95			
Landlord's Share of Total Cost ( $\$147.97/\$374.95$ ) $\times 100\% = 39\%$			
Tenant's Share of Total Costs ( $\$226.98/\$374.95$ ) $\times 100\% = 61\%$			

#### (i) Income Approach for Share Rentals

The income approach is used to calculate the profit remaining after the costs have been accounted for. It is really a budgeting method. Each party should calculate his expected profit from a lease arrangement prior to agreement.

**(a) Tenant's Position**

A tenant can use the income approach to estimate how much profit is available from a lease arrangement. If land becomes available for lease, the tenant can estimate how much rent he can afford to pay. If a landlord offers to rent land to him at a stated share ratio, the tenant can determine if the returns are sufficient to provide a satisfactory return on his machinery investment and for his labour input.

In the example in Table 4, no additional machinery was required. In the short run most farmers can handle a small increase in farm size with no additional machinery investment. However, it will involve more hours of labour to farm the entire farm operation. Timeliness of operation may be adversely affected. Often a farmer will expand his acreage and not change his existing line of machinery. When he begins to replace his machinery in the future he will buy larger machinery to accommodate the larger land base. Effectively, the additional land previously taken on does result in added machinery investment but at a later date. This possibility should be considered when renting additional land where there is no immediate change in machinery ownership. If additional machinery must be purchased, added depreciation and interest on investment should be charged as a cost against the land to be leased. Table 4 illustrates a budgeting technique to cost out additional machinery investment.

<b>Table 4: Income Approach for Share Rentals - Tenant Position</b>		
<b>Assumptions:</b>		
<ul style="list-style-type: none"> <li>• Landlord offers to rent 160 acres of land to a tenant for a 30% share of the crop.</li> <li>• Landlord will pay 30% of the fertilizer and chemical costs.</li> <li>• Landlord will pay property taxes and supply grain storage.</li> <li>• Tenant will follow a three year continuous crop rotation of spring wheat, canola and green peas.</li> <li>• Tenant does not require additional machinery investment.</li> <li>• All example numbers used are from the Ministry's Crop Planning Guide 2017. (Dark Brown Soil Zone)</li> </ul>		
<b>Tenant's Budget</b>		
<b>Income:</b>	(spring wheat yield 47.7 bu/acre, canola yield 41.6 bu/acre, green pea yield 41.0 bu/acre) (spring wheat price \$6.01 /bu, canola price \$10.58/bu, green pea price \$8.14/bu)	
	160 acres x (47.7 bu. x \$6.01+ 41.6 bu. X \$10.58 + 41.0 bu. X \$8.14)/3 years x 70%share	\$39,594
	Total Income	\$39,594
<b>Cash Expenses:</b>	(Total expense of the three crop rotation/ three years) = Average Yearly Expense	
	Seed (160 acres x \$41.77/ac.)	\$ 6,683
	Fertilizer (160 acres x \$41.96/ac. x 70%share)	\$ 4,700
	Chemicals 160 acres x \$95.04/ac x 70% share	\$10,644
	Machinery Operating Costs (160 acres x \$20.54)	\$ 3,286
	Crop Insurance (avg cost \$8.66/acre x 160 acres)	\$ 1,386
	Miscellaneous Cost (avg cost \$4.19 x 160 acres)	\$ 670
	Interest -operating capital (avg cost \$5.33 x 160)	\$ 853
	<b>Total Cash Expenses</b>	\$28,222
	Return above cash costs	\$11,372
	Return above cash costs = $\frac{\$11,372}{160 \text{ ac}} = \$71.08 \text{ per acre}$	

Table 5 illustrates how to calculate the cost of purchasing additional machinery.

<b>Table 5: The Cost of Purchasing Additional Machinery.</b>		
A farmer is going to lease an additional one-half section of land and estimates that he will require \$94,000 of additional machinery investment. (320 acres x \$293.68/acre machinery investment for Dark Brown Soil Zone)		
The estimated extra annual fixed costs are as follows:		
<b>Depreciation</b>		
$\frac{\text{Original Cost - Salvage Value (10\%)}}{\text{Years of Use}}$	$\frac{\$94,000 - \$9,400}{12 \text{ years}}$	\$7,050 per year
<b>Interest on Investment</b>		
$\frac{\text{Original Costs + Salvage Value}}{2} \times \text{Interest Rate}$	$\frac{\$94,000 + \$9,400}{2} \times 6\%$	\$3,102 per year
Insurance (0.5%) = \$94,000 x 0.5%		\$ 470 per year
Extra Annual Fixed Costs =		\$10,622 per year
Extra Fixed Costs/Acre = $\frac{\$10,622}{320 \text{ ac.}} = \$33.19$		

The tenant would include the \$33.19 in his estimate of the cost per acre to lease this property.

Tenants may enter into a lease where the expected profits are not adequate in the short run, but commodity prices are expected to improve and result in adequate profits in the near future. This is an important consideration if the lease is likely to be a long term arrangement or the tenant will have the option to buy the land.

#### **(b) Landlord's Position**

A landlord can use the income approach calculations to decide if the return is adequate. If it is not, he can attempt to obtain a higher share of the crop or negotiate a lease in which the tenant pays all the costs of fertilizer and chemicals. If this is not possible then the sale of land could be considered and the proceeds placed in alternative investments. Many landlords recognize that farm incomes tend to run in cycles and decide to ride out periods of low returns in anticipation of greater profits and capital appreciation in land values in the future.

A worksheet is provided in Appendix I to assist with crop share rental calculations. The example in Table 6 (next page) illustrates the income approach.

**Table 6: The Income Approach For Share Rental - Landlord Position**

<b>Assumptions:</b>	
<ul style="list-style-type: none"> <li>• Landlord can rent 160 acres for a rent of 30% crop share.</li> <li>• Landlord will pay 30% of fertilizer and chemical costs.</li> <li>• Landlord pays property taxes.</li> <li>• Property is valued at \$234,240 (\$1464/acre) including \$20,000 for grain storage (\$125/acre).</li> <li>• Tenant will follow a three year continuous crop rotation of spring wheat, canola and green peas.</li> <li>• All example numbers used are from the Ministry's Crop Planning Guide 2017. (Dark Brown Soil Zone)</li> </ul>	
<b>Landlord's Budget:</b>	
<b>Income</b>	
Wheat (47.7bu x \$6.01) Green Peas (41.0bu x \$8.14) (Canola (41.6bu@\$10.58)	160 acres x \$353.52 (3-year avg gross revenue per acre) x 30% share = \$16,969
<b>Total Income</b>	<b>\$16,969</b>
<b>Cash Expenses</b>	
Fertilizer	160 acres x \$41.96/acre x 30% share = \$2,014
Chemicals	160 acres x \$95.04/acre x 30% share = \$4,562
Property Taxes	160 acres x \$6.16 = \$986
Interest on Operating Capital	160 acres x \$5.33 x 30% = \$256
<b>Total Expenses</b>	<b>\$7,818</b>
<b>Return Above Cash Expenses</b>	<b>\$9,151</b>
<b>Return on Investment Calculation</b>	
Return Above Cash Expenses	\$9,151
Depreciation on Granary \$20,000 x 5%	\$1,000
<b>Return to Property Investment</b>	<b>\$8,151</b>
<b>% Return</b>	<b>= \$8,151 ÷ \$234,240 x 100% = 3.5%</b>

### Crop Share Lease Agreement Terms

In addition to the points listed for all leases, a crop share lease agreement should include the following:

#### (i) Cropping Decisions

Normally, the tenant makes the cropping decisions about crops to grow, acreages of each and use of inputs. Occasionally, the tenant may discuss cropping plans with the landlord and in some cases the landlord may want a direct say in the cropping decisions.

#### (ii) Use of Fertilizer and Chemicals

The tenant and landlord can agree to the amount of crop inputs to apply and as to how such costs will be shared. It is recommended that both parties share the cost of fertilizer and chemicals in the same proportion as the crop is shared. In situations where the tenant pays the entire cost, he has less financial incentive to apply optimum levels of crop inputs as compared to situations where both parties share those costs proportionally.



However, the method of sharing input costs should affect the division of the crop. For example, the tenant's share should be larger when he supplies all input costs as compared to a situation where some input cost are paid by both parties.

### **(iii) Crop Insurance**

- Hail insurance is offered by private companies as insurance against hail or fire on a spot loss basis.
- Revenue insurance is now offered by some private companies.
- A tenant or landlord may insure their share of the growing crop separately by purchasing insurance coverage separately from any company offering hail or revenue insurance.
- All risk crop insurance is offered by the Saskatchewan Crop Insurance Corporation which guarantees the value of a minimum level of grain production from all losses (hail, fire, theft, drought, etc.). Spot loss hail insurance is available as a rider to a producer's crop insurance contract.

There are two ways that Saskatchewan Crop Insurance can be handled in a crop share lease. These are:

- Only the tenant insures under the program. He pays all the premiums required and receives all the indemnities. The landlord has no coverage under these programs.
- The landlord and tenant can jointly share the costs and benefits of crop insurance even though the contract is with the tenant. The parties agree to share the premiums and benefits of crop insurance on the rented land in the same proportion as the share of crop. For example, assume the land farmed by the tenant consists of 100 acres of rented land and 500 acres of owned land with a Saskatchewan Crop Insurance premium of \$5,196 (three year avg rate of \$8.66/acre based on rotation example previously used). The premium associated with the rented land is  $100 \text{ acres} / 600 \text{ acres} \times \$5,196 = \$866$ . The landlord's share of the premium in a 33.3% - 66.7% crop share arrangement is  $33.3\% \times \$866 = \$288$ . Any benefits realized from All Risk Crop Insurance could be shared in the same manner. Claims under the Saskatchewan Crop Insurance Program are based on the total unit which combines the rented land and the operator's land. For this reason it could be difficult to determine the losses and benefits of All Risk Crop Insurance belonging to rented land.

### **(iv) Delivery and Sale of Grain**

Indicate who is responsible for the delivery and sale of crops grown.

### **(v) Value of Grain**

In a crop share lease arrangement, normally, the tenant delivers the landlord's share of the crop to the closest delivery point. The landlord receives the net cash price after elevator handling costs and freight costs are deducted for his share of the crop. The lease arrangement could include a clause that outlines the conditions for grain delivery and indicates how the transportation costs, freight costs and elevator charges are shared.

## Cash Lease Agreements

In a cash lease the tenant pays a fixed cash payment to the landlord for the use of the land and improvements. The tenant receives all the income. He supplies labour, machinery and pays all the expenses except for property taxes, building insurance and major building repairs.

A cash lease is especially suited to absentee landlords and other landlords who wish to be assured of stable income without much administration. With widely fluctuating grain prices landlords and tenants may not prefer a cash rent. A flexible cash rent which is tied to grain prices may be more appropriate.

The following are the advantages and disadvantages of cash leases:

### Advantages

- The landlord receives a guaranteed return and does not have to be concerned about crop yields, grain prices, crop rotations or the tenant's honesty. Because he accepts less risk, the rent is normally lower than on a crop-share basis.
- The tenant has more flexibility and independence in production and management decisions.
- The results of superior production accrue entirely to the tenant.
- There is less administration especially if dealing with multiple landlords.
- Production can be used for livestock feed or seed more easily than on a crop-share lease.

### Disadvantages

- The tenant assumes all production and marketing risk.
- Rent is paid in advance of crop sales. There is a greater requirement for operating capital.
- The landlord does not get the benefit of high prices or unusually good crops.
- Because of the risk of changing circumstances, the leases are normally short term.
- The landlord has less influence on a tenant's management.

### The Amount of Cash Rent

Landlords and tenants either jointly or individually may use budgeting guidelines to calculate cash rents or as background information to assist in making a decision about a cash rental offer. Three methods are used to arrive at cash rental rates. These are: (i) the cost approach (ii) the cropshare equivalent and (iii) the income approach.

- Cost Approach** - With the cost approach, the landlord determines all his costs associated with the ownership and leasing of the land. Costs include property taxes, insurance, depreciation and interest on investment. The cost approach does not consider the tenant's position. It indicates the amount of cash rent required by the landlord to achieve a specific return on his land investment.

Table 7: Cost Approach	
<b>Assumptions</b>	
Land value is \$234,420 for a quarter section.	
Landlord pays property tax.	
Supplies granaries with a value of \$20,000.	
Landlord's Costs:	
Property Taxes @ \$6.16/acre	\$986
Granary Depreciation - \$20,000 x 5%	\$1,000
Land Investment Cost - \$234,420 x 5%	\$11,721
<b>Total</b>	<b>\$13,707</b>
Cost per acre ( $\$13,707/160$ ) = \$85.67 per acre	

- ii. **Share Equivalent Approach** - The rent normally realized by a landlord from a crop share lease is the basis for the calculation of a cash rental amount.

The income from a normal crop share should be discounted (reduced) by a factor of 10 per cent to 20 per cent for two reasons. These are:

- a) A cash rental is normally paid before the crop is sold while the income from a crop share rental is received as the crop is sold. Therefore, the crop share rental amount should be reduced by the amount of interest that a landlord will gain by receiving the rental payments earlier.
- b) A landlord accepts less risk on a cash rental since the landlord's income on a crop share will vary with grain prices and yields.

<b>Table 8: Share Equivalent Approach</b>	
<b>Assumptions</b>	
Landlord has 160 acres to rent. Crop share to landlord in the district is a 25% share. Three-year crop rotation is spring wheat, canola and green peas. Expected prices are \$6.01, \$10.58 and \$8.14/bushel, respectively.	
<b>Expected Total Income:</b>	
Expected Yields =Wheat 47.7 bu, canola 41.6 bu, peas 41.0 bu	
160 acres x \$353.52 (avg gross return per acre)	\$56,563
Total Income	
\$56,563	
Share of Income - \$56,563 x 25% share	
\$14,141	
Income per acre = $\frac{\$14,141}{160 \text{ ac}}$	
\$88.38	
Income per acre (after 10% discount)	
\$79.54	
Income per acre (after 20% discount)	
\$70.70	

iii. **Income Approach**

The use of the income approach by tenants and landlords was discussed in the section on crop share leases. The value of this approach is just as important in determining a cash rental. For a tenant, the difference between a cash rental and crop share rental in relation to the income approach is that he would be entitled to all the income from crop production and government payments. Further, there would be no sharing of crop input expenses.

The income approach is a valuable technique to assist a tenant in deciding what level of cash rent to offer to a landlord or to determine if he can afford to pay the cash rent asked by a landlord.

Worksheets in Appendix I are provided to assist in planning cash rent and crop share rental amounts.

**Cash Lease Agreement Terms**

In addition to the points listed for all leases, a cash lease should include the following:

- Date(s) on which the rental is payable.
- The payment of the cash rent can be any schedule agreed upon by the landlord and tenant. Examples:
  - a) The rental is payable in full by April 1 for each year of the agreement; or
  - b) The rental is payable (one-half, one-third, etc.) by April 1 and the balance by December 1 for each year of the agreement.

### **Special rights of the landlord if the rent is in arrears**

The landlord should be given the right to repossess and occupy the rented land if the tenant fails to make the payments according to the schedule outlined in the agreement.

In addition, he may use any other means under the law (e.g., seizure of crop, grain or chattels), to collect the rental. If this becomes necessary, legal advice should be obtained before any action is taken.

### **Flexible Cash Lease Agreements**

Flexible cash leases are cash rentals with features which allow the actual amount of rent paid to vary with changing conditions; usually changes in prices or production, or both. Flexible cash leases combine some of the features of each of the cash lease and crop share lease.

Flexible cash leases that are adjusted with changing production or yields can be complex to administer, since accurate production records are required. The need for flexibility in cash rent leases is more important when sharp swings in grain prices occur.

It is important to keep the lease and the procedures for calculating the rent simple. It is often better to enter into a crop share lease rather than a complex system which involves a cash rent based on production and price changes.

Flexible cash leases in which the rental rate adjusts with the price of grain are more appropriate and simpler to administer.

### **Administration**

Flexible rental rates based on grain prices can be administered in three ways. These are:

- A quantity of grain of a specific grade is agreed to by the tenant and landlord for each acre of land or quarter section of land to be leased.
- The cash rent is determined by multiplying the quantity of grain by the price of grain. The parties could agree beforehand to a date on which the price would be set (e.g. street price on October 15 of each year).
- A third method is used where there is a minimum guaranteed cash rent and a set gross revenue level. When gross revenue achieved exceeds that level there is a sharing of the excess based on a predetermined formula.

The landlord may require the tenant to make an advance payment in the spring before the crop is seeded. This would be applied against the payment in the fall when the street price can be determined.

The tenant delivers into an elevator in the landlord's name, an agreed to quantity and grade of grain (e.g. 800 bushels of No. 2CWRS - 13.5 spring wheat for a quarter section of land).

If a grade other than that agreed to was delivered, then a cash adjustment would be required between the two parties.

### **Advantages**

- The tenant has greater independence in decision making.
- The risk of changes in grain prices are shared by the landlord and tenant.
- The tenant captures all the benefits of superior management.
- There is less administration as compared to a crop-share lease but more compared to a cash lease.
- The landlord's rent is guaranteed in relation to quantity but not the price of grain.

### **Disadvantages**

- The tenant assumes all the risks of crop production.
- The landlord has less influence on the tenant's management.
- Marketing decisions can have a huge impact on this method unless the fixed pricing date is used. This can lead to more administration or joint decision making as may be required.

### **The Amount of Flexible Cash Rent**

The quantity and grade of grain in a flexible cash lease should relate to normal crop production on the leased land, normal grades of grain grown and the normal share that a landlord would receive in a crop share lease.

Although the tenant may grow any crop or combination of crops, it is usually preferable to use one commonly grown grain as the base for rent calculation.

The example in Table 9 (next page) illustrates a procedure to calculate the amount of flexible cash rent. Other types of flexible cash lease agreements may account for variations in both grain prices and crop yields. However, these agreements are more complex and often a crop-share lease would be the better type of lease to use.

### **Flexible Cash Lease Agreement Terms**

In addition to the points listed for all leases, a flexible cash lease should include the following:

- Dates on which rental is payable and the method of calculating the rental.
- The delivery point at which prices are to be determined or to which the landlord's quantity of grain is to be delivered.
- Special rights of the landlord if the rent is in arrears. The landlord should be given the right to repossess and occupy the rented land if the tenant fails to make the payments according to the schedule outlined in the agreement. In addition, he may use any other means under the law (e.g. seizure of crop, grain or chattels) to collect the rental. If this becomes necessary legal advice should be obtained before any action is taken.

**Table 9: The Amount of Flexible Cash Rent****Assumptions:**

1/4 section of land, 160 acres cultivated, Crop Rotation: Spring Wheat--Canola—Green Peas, Yields: Wheat 47.7 bushels per acre, Canola 41.6 bushels per acre, and Peas 41.0 bushels per acre. Crop Share in District: 25% share to landlord. Dark Brown Soil Zone.

<b>Step 1:</b> Calculate Average Annual Production	
	160 acres spring wheat x 47.7 bu/ac (A) = 7,632 bu.
	160 acres canola x 41.6 bu/ac (B) = 6,656 bu.
	160 acres green peas x 41.0 bu/ac (C) = 6,560 bu.

<b>Step 2:</b> Calculate Landlord's Normal Share	
	Spring Wheat 7,632 bushels x 25% share = 1,908 bushels
	Canola 6,656 bushels x 25% share = 1,664 bushels
	Green Peas 6,560 bushels x 25% share = 1,640 bushels

<b>Step 3:</b> Reduce landlord's normal share by 5% to 15% to account for the interest on the timing of rent payment and risk as compared to a crop share rental. (Note that this adjustment is suggested as being less than the adjustment for a full cash rental.)	
	Spring Wheat Bushel Rent = (1,908 bu - 10% discount) = 1,717 bushels
	Canola Bushel Rent = (1,664 bu - 10% discount) = 1,498 bushels
	Green Peas Bushel Rent = (1,640 bu - 10% discount) = 1,476 bushels

<b>Step 4:</b> Calculate Rent Based on Grain Price			
	<b>Price (\$/bushel)</b>	<b>Landlord's Quantity (bushels)</b>	<b>Total Rent</b>
Wheat	6.01	1,717	\$10,319
Wheat	5.00	1,717	\$8,585
Wheat	7.00	1,717	\$12,019
Canola	10.58	1,498	\$15,849
Canola	9.00	1,498	\$13,482
Canola	12.00	1,498	\$17,976
Peas	8.14	1,476	\$12,015
Peas	7.00	1,476	\$10,332
Peas	9.00	1,476	\$13,284

## Other Types of Lease Arrangements

### Pasture Leases on Privately Owned Land

Pasture lease rates are established by negotiation between landlords and tenants. The rental rate should relate to the type of forage, its conditions, carrying capacity and related ownership costs.

The amount of rent for pasture land, and whether the rent is fair to the owner and tenant is very dependent upon the carrying capacity of the pasture. The concept of the **Animal Unit** has been developed to permit the rating of pasture capacity and to facilitate rental agreements based on the amount of grazing which a pasture provides.

An Animal Unit is considered to be one mature cow at 1,000 lbs. which consumes about 26 pounds of forage per day. An Animal Unit Month (AUM) is the amount of feed consumed by one animal unit in one month. Most pastures are rented for the entire season, but in some cases, short-season pasture may be available or the number of animals on pasture may vary. For these arrangements, the use of rents based on animal unit months is essential.

<b>Table 10: Animal Unit Equivalents</b>				
<b>Animal Species</b>	<b>Weight (lbs.)</b>	<b>AUM Equivalent</b>	<b>Forage Dry Matter (daily lbs.)</b>	<b>Number Per AUM</b>
<b>Cow</b>	<b>1,000</b>	<b>1.0</b>	<b>26.0</b>	<b>1.0</b>
<b>Cow</b>	<b>1,500</b>	<b>1.5</b>	<b>39.0</b>	<b>0.7</b>
<b>Heifer</b>	<b>700</b>	<b>0.7</b>	<b>18.0</b>	<b>1.4</b>
<b>Bull</b>	<b>1,500</b>	<b>1.5</b>	<b>39.0</b>	<b>0.7</b>
<b>Horse</b>	<b>1,400</b>	<b>2.0</b>	<b>52.0</b>	<b>0.5</b>
<b>Sheep</b>	<b>120</b>	<b>0.2</b>	<b>5.2</b>	<b>5.0</b>
<b>Deer</b>	<b>160</b>	<b>0.25</b>	<b>6.5</b>	<b>4.0</b>
<b>Bison</b>	<b>1,500</b>	<b>1.5</b>	<b>39.0</b>	<b>0.7</b>
Source: Managing Saskatchewan Rangeland, 2008 (pg.72)				

#### (i) The Market Approach

The market approach is used to calculate a cash rent for a pasture based upon animal unit capacity and a market rate per animal unit in the area. For example, if a landlord has 320 acres of pasture that can carry 50 animal units for 120 days and the market rate in the area is \$1.67 per animal unit per day then the annual cash rent for the pasture could be 50 Animal Units x 180 days x \$1.67/Animal Unit/day = \$15,030 cash rent.

**(ii)The Cost Approach**

The cost approach estimates the landlord's costs to own the pasture land. These costs include interest on investment, depreciation, property taxes, insurance and the costs to establish and break the forage crop (for tame forages only).

The example in Table 11 illustrates the cost approach.

<b>Table 11: The Cost Approach - Pasture Land</b>			
<b>Assumptions:</b>	1/2 section seeded pasture @ \$625/acre = \$200,000 value Property Taxes @ \$2.00/acre = \$640 (per year) Fencing: 3.5 miles x \$5,300/mile = \$18,550 value Water Supply: Dugout: \$12,000 cost Breaking, Seeding and Re-grassing Costs = \$75.00/acre Life of Pasture--10 years Stocking Rate--300 animal unit months (50 animal units for 6 months) Based upon a 1,000 pound cow		
<b>Land Costs:</b>	Interest on Investment:	$\$200,000 \times 5\% =$	\$10,000
	Property Taxes:		\$ 640
<b>Fencing Costs:</b>	Interest on Average Investment	$\$18,550 \div 2 \times 8\% =$	\$ 742
	Depreciation:	$\$18,550 \times 5\% =$	\$ 928
	Repair Allowance:	$\$18,550 \times 2\% =$	\$ 371
<b>Water Costs:</b>			
	Interest on Average Investment	$\$12,000 \div 2 \times 8\% =$	\$ 480
	Depreciation:	$\$12,000 \times 5\% =$	\$ 600
<b>Breaking, Seeding and Re-grassing Costs:</b>		$\frac{\$75/\text{ac} \times 320 \text{ ac}}{10 \text{ years}}$	\$ 2,400
		<b>Total Annual Costs</b>	\$16,161
<b>Pasture Cost Summary</b>			
<b>Cost/Animal Unit Month</b>	<b>Cost/Animal Unit/Grazing Season (6 months)</b>		<b>Cost Per Acre</b>
$\$16,161/300=\$53.87$	$\$16,161/50 = \$323.22$		$\$16,161/320 = \$50.50$



**(iii) The Contributions Approach**

The contributions approach can be used to establish a flexible rent based on the value of calves. The cost contributions of the producer and the landlord who owns the pasture are determined. An equitable share of the value of calves to compensate the landlord for his pasture can then be determined. The example illustrates this procedure and it shows that approximately 21 per cent of the total cow calf production costs are related to pasture. Therefore, the pasture owner would be entitled to 21 per cent of the value of calves produced each year.

If the pasture owner's percentage contribution was 21 per cent, the average calf weight was 550 lb., the average calf crop was 90 per cent and the average calf price was \$1.90/lb., then the rent per cow per season would be calculated as shown in the following chart.

<b>Rent/cow/season = Pasture Owners Percentage Contribution = 21%</b>
Average Calf Weight x 550
Average Calf Prices x 1.90/lb.
Average Calf Crop x 90%
Rent/cow/season = \$197.51

Rather than use the above formula, a simpler approach would be to set the rent per cow per season as a percentage of the average price of calves quoted in dollars per hundredweight (\$/cwt). One hundred-four per cent of the price of calves in \$/cwt would give approximately the same result as the above formula.

<b>Calf Price</b> (\$/cwt)	<b>Rent/Cow/Season</b> (104% of calf prices)
170.00	176.80
180.00	187.20
190.00	197.60
200.00	208.00

Rental payments could be based on calf prices in the fall averaged over several weeks or based on a specific date. A partial rental payment could be made in the spring of the year before grazing commences with a final payment in the fall after calf prices are determined.

<b>Table 12: The Contribution Approach</b>	
<b>Pasture Land</b>	
<b>Pasture Owner's Costs:</b>	\$/cow
Pasture (see previous example)	\$323
<b>Cow Calf Producer's Costs:</b>	
<b>Operating Costs</b>	
Feed	\$341
Bedding	30
Veterinary and Medicine	23
Breeding	106
Herd Replacement	252
Death Loss	30
Marketing	38
Fuel, Lube and Repairs	69
Manure Removal	8
Facility and Fence	20
Miscellaneous	26
<b>Subtotal Operating</b>	<b>\$943</b>
Operating Interest	\$ 26
<b>Total Operating Costs</b>	<b>\$969</b>
<b>Fixed Costs</b>	
Facilities	\$20
Equipment	43
<b>Interest on Investment</b>	
Facilities	10
Equipment	11
Breeding herd (50 cows @\$2,000, 2 bulls @ \$5,000) x 5% = \$5,500/50 cows	110
<b>Total Fixed Costs</b>	<b>\$194</b>
Labour and Management	\$75
<b>Total Producer's Costs</b>	<b>\$1,238</b>
<b>Total All Costs</b>	<b>\$1,561</b>
Pasture Owner's Share =	$\frac{\$323}{\$1,561} \times 100 = 21\%$
Producer's Share =	$\frac{\$1,238}{\$1,561} \times 100 = 79\%$

Pasture rental rates based on calf prices facilitates longer term leases since rental rates adjust automatically with market conditions.

A worksheet is provided in Appendix II to assist with pasture land lease calculations. The example in Table 12 (prior page) illustrates the contribution approach.

#### **(iv) The Income Approach**

With the income approach the tenant would estimate the income from using the pasture, and subtract his costs of production from that amount. This leaves a residual amount that can be paid for pasture.

In the example above, a cow calf enterprise is expected to have a cost for the enterprise for all items except the pasture costs for the year of \$1,238 per cow. Using the same information above for income, the expected income would be (550 lbs. x \$1.90 x 90%) \$941 per cow. The residual value of minus (\$297) would be the return to the pasture land.

In this example the income approach leaves a negative residual return to the pasture. The cow calf producer may want to examine some of the fixed costs (interest on investment and depreciation) and labour and management estimates. These costs may be incurred with or without the rented pasture land and the cattle that would utilize the pasture land.

#### **Pasture Lease Agreement Terms**

The following items should be included in a pasture lease agreement in addition to clauses that apply to all leases:

- Date of rental payment.
- Method of calculating the rental payment if a flexible rental arrangement is used.
- Grazing period permitted and other limitations on grazing.
- Number of livestock permitted on the land.
- Rights of the tenant to cut hay.
- Responsibility for fertilization, rejuvenation, re-breaking and seeding.

#### **Hay Leases on Privately Owned Land**

Farmers often purchase standing hay from landowners. The settlement may be made to the landowner as a rent per acre, a rent per ton or the landlord may receive a share of the hay harvested. The settlement should relate to the quality of the hay, size of fields, yield per acre and condition of the field. Local market conditions are a primary factor in determining values.

The contributions approach, the cost approach and the income approach are procedures that can be used as guidelines to determine shares or a value for standing hay. An example in Table 13 (next page) illustrates these three approaches to determining shares or a value for standing hay.

With the **contribution approach** a 46% - 54% (Landlord/Purchaser) ratio is calculated. The hay purchaser could supply 46% of the hay to the landlord or pay cash equal to 46% of the value of the hay. For example, if hay was valued at \$80.00 per ton the landlord would receive \$36.80/ton (46% x \$80.00).

With the **cost approach**, the landlord would have to charge \$45.75 per acre or \$30.50 per ton (\$45.75/1.5 ton/acre) to cover his fixed and variable costs.

With the **income approach**, the hay purchaser would subtract his total costs to harvest the hay from the value of the hay leaving a residual value. For example, if hay was valued at \$80.00 per ton and the hay purchaser's costs were \$54.00 ton, then he could afford to pay \$26.00 per ton (\$80.00-\$54.00) to the landlord for the hay. The value of silage could be determined using the same methods after adjustments for moisture content.

Table 13: Contribution Approach - Hay Leases			
Landlord's Costs	\$/acre	Hay Purchaser's Cost	\$/acre
Interest on Land Investment		(Based on 1.5 ton hay/acre)	
\$625/ac x 5%	\$31.25	Cutting, conditioning, baling and	
Property Taxes	2.00	hauling (custom rates less profit	
Seed, Breaking and Reseeding		margin) \$35.00/ton x 1.5 ton	\$52.50
\$75.00/acre/6 years	12.50	Twine \$1.00/ton x 1.5 ton	1.50
Total	\$45.75	Total	\$54.00
Total Contributions     \$45.75 + 54.00 = \$99.75			
Landlord's Share = \$45.75/\$99.75 x 100% = 46%			
Hay Purchaser's Share = \$54.00/\$99.75 x 100% = 54%			

## Custom Farming Arrangements

### Maintain Farmer Status

Frequently, a landlord wishes to remain classified as a farmer and retain close control of the farming business but not be actively involved in its operation. A custom farming agreement may accomplish this objective.

In addition to maintaining control over the farm and being involved in the farming decisions, there are several tax and estate planning options that are available to farmers and not landlords. These options need to be considered. As an example, a farmer, but not a landlord, is able to make contributions to the Canadian Pension Plan on earnings from the farm business. **These rules are complex and a lawyer, accountant or farm management agrologist should be consulted before entering into a custom farming agreement.**

The custom operator in a custom farming agreement does not have the same rights as a tenant in a landleasing agreement. A custom farming agreement is not an interest in land. Consequently, a registered interest cannot be placed against the owner's title to protect the custom operator's interest, or to warn third parties of its existence.

If the owner sold the land covered by a custom farming agreement to a third party, the custom operator would have no right to continue farming the land and would have to sue the original owner for contractual damages.

### **Preservation of Capital Gain Rollover Provisions to a Child**

Land may be rolled over on a tax deferred basis when it is transferred from a parent to a child, providing that the property was before the transfer used principally in the course of carrying on farming in Canada in which the taxpayer, the taxpayer's spouse, or any of the taxpayer's children, was actively engaged on a regular and continuous basis. Land which is leased to anyone other than a spouse, a child, a family farm corporation or family farm partnership may not qualify for a rollover.

### **Capital Gain Exemption on Eligible Farm Properties**

To be eligible for the lifetime capital gains exemption on farmland, the land must be "qualified farm property". Qualified farm property is determined by the following factors: who owns it, type of property, who uses it, years of ownership and sources of income.

#### **Qualified farm property**

"Qualified farm property" of an individual (other than a trust that is not a personal trust) at any particular time means a property owned at that time by the individual, the spouse of the individual or a partnership, an interest in which is an interest in a family farm partnership of the individual or the individual's spouse that is

#### **(a) Real Property That Was Used By:**

- i) the individual,
- ii) a beneficiary of the individual trust,
- iii) a spouse, child or parent of a person referred to in subparagraph (i) or (ii),
- iv) a corporation, a share of the capital stock of which is a share of the capital stock of a family farm corporation of an individual referred to in any of subparagraphs (i) to (iii), or
- v) a partnership, an interest in which is an interest in a family farm partnership of an individual referred to in any of subparagraphs (i) to (iii),

**in the course of carrying on the business of farming in Canada and, for the purpose of this paragraph, property will not be considered to have been used in the course of carrying on the business of farming in Canada unless:**

- vi) the property or property for which the property was substituted (in this subparagraph referred to as "the property") was owned by a person who was the individual, a beneficiary referred to in subparagraph (ii) or a spouse, child or parent of the individual or of such a beneficiary, by a personal trust from which the individual acquired the property or by a partnership referred to in subparagraph (v) throughout the period of at least 24 months immediately preceding that time, and;
- in at least 2 years while the property was so owned the gross revenue of such a person, or of a personal trust from which the individual acquired the property, from the farming business carried on in Canada in which the property was principally used and in which such a person or, where the individual is a personal trust, a beneficiary of the trust was actively engaged on a regular and continuous basis exceeded the income of the person from all other sources for the year, or

- the property was used by a corporation referred to in subparagraph (iv) or a partnership referred to in subparagraph (v) principally in the course of carrying on the business of farming in Canada throughout a period of at least 24 months during which time the individual, a beneficiary referred to in subparagraph (ii) or a spouse, child or parent of the individual or of such a beneficiary was actively engaged on a regular and continuous basis in the farming business in which the property was used, or

vii) where the property is a property last acquired by the individual or partnership before June 18, 1987, or after June 17, 1987 under an agreement in writing entered into before that date, the property or property for which the property was substituted (in this subparagraph referred to as "the property") was used by the individual, a beneficiary referred to in subparagraph (ii) or a spouse, child or parent of the individual or of such a beneficiary, a corporation referred to in subparagraph (iv) or a partnership referred to in subparagraph (v) or by a personal trust from which the individual acquired the property principally in the course of carrying on the business of farming in Canada:

- in the year the property was disposed of by the individual, or
- in at least 5 years during which the property was owned by the individual, a beneficiary referred to in subparagraph (ii) or a spouse, child or parent of the individual or of such a beneficiary, by a personal trust from which the individual acquired the property or by a partnership referred to in subparagraph (v),

**(b) Interest in a Family Farm Partnership**

"Interest in a family farm partnership" of an individual (other than a trust that is not a personal trust) at any time means an interest owned by the individual at that time in a partnership where throughout any 24-month period ending before that time, more than 50% of the fair market value of the property of the partnership was attributable to:

(i) property that was used by

- A. the partnership,
- B. the individual,
- C. where the individual is a personal trust, a beneficiary of the trust,
- D. a spouse, child or parent of the individual or of a beneficiary referred to in clause (C), or
- E. a corporation, a share of the capital stock of which was a share of the capital stock of a family farm corporation of the individual, a beneficiary referred to in clause (C) or a spouse, child or parent of the individual or of a beneficiary referred to in clause (C), principally in the course of carrying on the business of farming in Canada in which the individual, a beneficiary referred to in clause (C) or a spouse, child or parent of the individual or of a beneficiary referred to in clause (C) was actively engaged on a regular and continuous basis,

(ii) shares of the capital stock or indebtedness of one or more corporations all or substantially all of the fair market value of the property of which was attributable to properties described in subparagraph (iii), or

(iii) properties described in either subparagraph (i) or (ii), and

at that time, all or substantially all of the fair market value of the property of the partnership was attributable to:

- i. property that was used principally in the course of carrying on the business of farming in Canada by the partnership or a person referred to in subparagraph (a)(i),
- ii. shares of the capital stock or indebtedness of one or more corporations described in subparagraph (a)(ii), or
- iii. properties described in subparagraph (i) or (ii).

**(c) Share of the Capital Stock of a Family Farm Corporation**

"Share of the capital stock of a family farm corporation" of an individual (other than a trust that is not a personal trust) at any time means a share of the capital stock of a corporation owned by the individual at that time where throughout any 24-month period ending before that time, more than 50% of the fair market value of the property owned by the corporation was attributable to:

- (i) property that was used by
  - A. the corporation,
  - B. the individual,
  - C. where the individual is a personal trust, a beneficiary of the trust,
  - D. a spouse, child or parent of the individual or of a beneficiary referred to in clause (C), or
  - E. a partnership, an interest in which was an interest in a family farm partnership of the individual, a beneficiary referred to in clause (C) or a spouse, child or parent of the individual or of such a beneficiary principally in the course of carrying on the business of farming in Canada in which the individual, a beneficiary referred to in clause (C) or a spouse, child or parent of the individual or of such a beneficiary, was actively engaged on a regular and continuous basis,

(ii) shares of the capital stock or indebtedness of one or more corporations all or substantially all of the fair market value of the property of which was attributable to property described in subparagraph (iii), or

(iii) properties described in either subparagraph (i) or (ii), and

at that time, all or substantially all of the fair market value of the property owned by the corporation was attributable to:

(i) property that was used principally in the course of carrying on the business of farming in Canada by the corporation or a person or partnership referred to in subparagraph (a)(i),

(ii) shares of the capital stock or indebtedness of one or more corporations all or substantially all of the fair market value of the property of which was attributable to property described in subparagraph (iii), or

(iii) properties described in either subparagraph (i) or (ii).

**(d) Eligible Capital Property**

An eligible capital property used by a person or partnership referred to in any of subparagraphs (a)(i) to (v), or

by a personal trust from which the individual acquired the property, in the course of carrying on the business of farming in Canada and, for the purpose of this paragraph, eligible capital property:

(i) will not be considered to have been used in the course of carrying on the business of farming in Canada unless the conditions set out in subparagraph (a)(vi) or (vii), as the case may be, are met, and

(ii) shall be deemed to include capital property to which section 70(5.1)(b) or 73(3)(d.1) of the *Income Tax Act* applies;

### **Implications of the Capital Gain Exemption**

- A taxpayer who farmed land for more than two years and had gross farm income greater than income from all other sources for at least two years, died in 1996 and leaves the land to a spouse. The spouse immediately has qualified farm property.
- A child who is not a farmer, purchases farmland in 1988 and leases it to his father. The father uses the land in a farm business for two or more years and has gross farming income in excess of all other income sources for at least two years during the time the child owns the property and during the time the child owns the property and during the time the father farms the land. The child would have qualified farm property.
- A family farm partnership can sell real property and have the capital gains exemption apply.
- The definition of a child includes a grandchild or great grandchild of a taxpayer; however, the definition of a parent does not include the grandparent or great grandparent of a taxpayer.

It should be noted that even though the taxable capital gains realized on the sale of farmland may be offset with the capital gains exemption, the non-taxable portion may be subject to minimum tax.

### **Capital Gain Exemption on a Property Exchange**

For a rollover of capital gain to occur on a property exchange, the land must be "used principally in the course of carrying on the business of farming in Canada" by the owner or a related person. Land leased to anyone other than a related person would prevent a property exchange rollover from occurring.

### **Structure of a Custom Farming Agreement**

In a properly structured custom farming agreement, the land will be considered to be "used principally in the course of carrying on the business of farming" as opposed to being a rental as in a lease agreement. This will allow the farm owner to use some of the estate planning and tax options that are available. With a custom farming agreement a farm owner may engage the services of another person to undertake virtually all of the work associated with his farming activities. However, the owner of the farm property must assume some risk and provide the management for the operation.

To be at risk, the farm owner should pay some of the operating costs and stand to lose money if there was a crop failure. His management should take the form of decision making responsibilities for such functions as determining crops and varieties to be grown, fields to be seeded and fallowed, timing of field operations, inputs to be used and dates of crop sales. In using custom farming agreements, it is important that the actual relationship that exists between the landowner and the custom operator conforms to the agreement. **Revenue Canada will look at the actual facts of the situation, not the agreement, if there are discrepancies between an agreement and the facts of the situation.**

Landowners should consider documenting their decision making responsibilities by way of copies of letters of instruction or minutes of meetings.

### **Types of Custom Farming Agreements**

There are many variations to custom farming agreements. However, three general categories of arrangements exist. These are:

#### **(i) Custom Hiring Agreement**

The landowner (farmer) makes all the farming decisions, arranges for and pays for the purchase of all inputs and receives all the income from grain sales. The landowner and the custom operator agree to have the custom operator perform some or all machine operations. The landowner agrees to pay a custom fee to the custom operator upon the completion of each machine operation.

A variation of the above is for the landowner to pay the custom operator a basic lump sum fee by a certain date say, July 31, of each year plus a bonus after the final accounting is completed for the year. The bonus could be a percentage, say 40% of "net income". "Net income" would be the value of all crop sales attributed to the year minus the costs of custom work, seed, fertilizer, chemicals and property taxes. The bonus percentage amount should depend on the size of the basic lump sum fee in relation to actual custom rates in the area.

#### **(ii) Joint Farming Venture Agreement**

In this agreement, both parties are considered to be farmers. The landowner supplies land to the joint venture and the other party supplies machinery, machinery operating costs and labour.

The two parties then share the crop sales on a percentage basis and also share the input costs (seed, fertilizer, chemicals, crop and revenue insurance) on the same basis. Both parties benefit from crop insurance coverage and revenue insurance indemnities.

#### **(iii) Farming Partnership Agreement**

The agreement is much the same as in the joint venture, except that a partnership is established with more defined rules to govern the relationship. Some custom farm agreements have been drafted in a manner that gives the same financial results as a crop share lease. A common agreement is one where the landowner (the "farmer") sells the entire crop in the "farmer's" name. After each grain sale is received, the "farmer" pays cash equal to, say, 66.7% of the income received to the custom operator. The custom operator supplies seed, fertilizer, chemicals, machinery, labour and machinery operating costs. It is quite evident that this type of agreement is the same as a crop share lease.

Revenue Canada is very likely to look at these agreements as leases. Therefore, the landowner would not qualify for a capital gain rollover to his child, capital gain exemption on qualified property or a rollover on a property exchange.

Consult a lawyer, accountant or farm management agrologist before entering into any custom farming agreement since some agreements may not meet the "used principally in the course of carrying on the business of farming" criteria. It is important to review custom farming agreements that were entered into several years ago to determine if they are in tune with current requirements.



## **Land Leases and the *Income Tax Act***

The following information outlines the major provisions of *The Income Tax Act* as related to leasing of farmland between private parties. It should not be considered as either interpretation or complete coverage of *The Income Tax Act* and the Government of Saskatchewan assumes no responsibility towards persons using it as such. It is recommended that you consult a farm management agrologist, accountant, tax consultant, Revenue Canada, or lawyer concerning your specific arrangements and any questions regarding the interpretation or application of *The Income Tax Act*.

## **Income and Expenses**

*The Income Tax Act* indicates the income and expenses which may be claimed by the farmer (tenant) and landlord. For example, cash rental payments are income to the landlord and a deductible expense for the tenant. Crop-share payments are income to the landlord. They are not a deductible expense for the tenant unless he reports the total gross income from the rented property. The tenant may claim the cost of repairs as a deduction and capital cost allowance on improvements which he makes to the landlord's property. Landlords can claim capital cost allowance on depreciable property **included** in the lease.

## **Non-Resident Withholding Tax**

If the landlord is a non-resident of Canada and resides in the U.S.A., the tenant must withhold 25% of the rent (cash rental or crop-share) and send it to Revenue Canada. A common practice with crop-share lease agreements is to have a separate bank account in the name of the landlord. The tenant deposits the landlord's share of crop in the account with the provision that the bank will remit 25% to Revenue Canada. When the tenant does not remit the 25% withholding tax, Revenue Canada will attempt to collect the tax from the landlord. If the landlord does not pay this tax, the tenant will be held responsible.

The withholding tax rate will vary for non-residents residing in countries other than the U.S.A. Check with a Professional Accountant or Revenue Canada for specific rates in other countries.

The individual who remits the withholding tax must complete and forward an NR4 Return to Revenue Canada at the end of the year.

## **Capital Cost Allowance**

When a land owner rents his farm land, buildings or machinery, the *Income Tax Act* requires that he switch from the Straight Line Method (Part XVII) of capital cost allowance to the Declining Balance Method (Part XI). In most cases this is undesirable since it would mean that all recaptured capital cost allowance that occurs when the class is closed out (e.g., sale of all machinery in that class) would be taxable income. This problem could be avoided by the tenant hiring the machinery on a custom basis with the fee being a share of the crop or cash payment. For this situation, switching to Part XI method of capital cost allowance is not required.

Where the tenant makes improvements to the rented property at his own expense he is entitled to claim capital cost allowance on depreciable items. These improvements might include major alterations to existing structures or the construction of dugouts, dams, fences and corrals, permanent grain storage and livestock buildings.

If the tenant receives compensation from the landlord or sells the asset, recaptured capital cost allowance and capital gain might occur. Since permanent improvements belong to the land, they are legally owned by the landlord. For this reason it is important the tenant receive fair compensation whether it is in the form of reduced rent or cash payment.

### **Canada Pension Plan and Registered Retirement Savings Plan**

Rental income cannot generally be used as a basis for contributions to the Canada Pension Plan. Farmers who lease their land and have no employment or self-employment income will be unable to make contributions to the plan. This will have the effect of reducing their Canada Pension Plan pension at the time it commences.

Although rental income is not generally eligible for contributions to the Canada Pension Plan, it is earned income for the purpose of contributions to a Registered Retirement Savings Plan. However, it should be noted that the Canada Revenue Agency does recognize crop share income as farm income; therefore, it may be eligible for CPP and RRSP purposes.

Rather than lease his land a landowner may consider hiring the farm work on a custom basis or enter into a joint venture or partnership. The net income from these sources is eligible for contributions to the Canada Pension Plan.

### **Capital Gains Rollover**

An individual may transfer farmland to any of his children either during his lifetime or after his death on a capital gain rollover, providing that the land was used principally in the course of carrying on the business of farming by himself, his spouse or any of his children. Children include sons-in-law, daughters-in-law, grandchildren, great grandchildren and a person who, under the age of 19 years, was wholly dependent on the taxpayer for support and was lawfully under the taxpayer's custody and control.

If the land is leased to someone other than a spouse, a child or to a corporation or partnership operated by him, his spouse or a child, a capital gain rollover to a child is not possible. For this reason, many landowners hire the farm work on a custom basis rather than leasing. This preserves the capital gain rollover (see the section on Custom Farming Arrangements).

### **Capital Gains Tax Exemption**

"Qualified farm property" is eligible for a lifetime capital gains exemption. (See the section Custom Farming Arrangements.)

### **Goods and Service Tax (GST)**

Rent which is paid by way of crop share is not subject to the goods and service tax. The treatment of cash rents for GST purposes depend on whether the landlord is registered with Revenue Canada, to collect and remit the GST. Generally, a business (including a landlord who rents property) will not have to register if their taxable and zero-rated sales are under \$30,000. A landlord whose only source of business income is rent and the amount is less than \$30,000 need not register. If a landlord is not a GST registrant, then the landlord is not required to charge the tax on the rent. The landlord is unable to recover GST paid on taxable goods and services but may claim the full amount (including GST) as allowed for business expense deductions for income tax purposes.

However, if the landlord is registered, then the GST must be charged on cash rentals. The landlord must remit the GST collected when his GST return is filed. The tenant is able to claim an Input Tax Credit on the tax paid.

### **Land Leases and the Law**

The following is an outline of the law pertaining to land leases between private parties. It should not be considered as legal advice and the Government of Saskatchewan assumes no responsibility towards persons using it as such. It is recommended that you consult a lawyer concerning your specific arrangements and any questions regarding the interpretation or application of the law.

A land lease is a contract by which one person, called the landlord or lessor, conveys the use of real (land) property to another person, called the tenant or lessee, for a period of time, called the term, for a consideration called rent.

A lease agreement is like all other contracts in that both parties must be competent to contract. A lease by or to a minor or mentally incompetent person may not be binding on the parties. A lawyer should be consulted prior to entering into such a lease. A lease arrangement can be for any specified period of time.

The following are general notes with respect to land leases:

#### **Verbal Lease**

The law relating to verbal leases comes from the common law and old English statutes, as opposed to more modern legislation such as *The Land Titles Act* or *The Landlord and Tenants Act*. The law on verbal leases is somewhat unclear, and in general, verbal arrangements should be avoided.

A verbal lease for a term not exceeding three years may be valid. If the land includes the landlord's homestead, a verbal lease is not binding since the landlord's non-owning spouse must give written consent to the agreement. A written lease must be completed for the homestead quarter, and is generally recommended for all situations regardless of the term.

A verbal lease does not have to be registered at the Land Titles Office. If another person should purchase the land from the landlord, the new landlord must honour the existing lease providing the tenant is in actual occupation of the land. The onus is therefore on the purchaser to ensure the property has not been rented out either under a verbal or written agreement. The purchaser should make enquiries in the district to determine who farmed the land last year.

If the land comprises the landlord's homestead a verbal contract is not binding since the landlord's non-owning spouse must give written consent to the agreement. For this reason it is recommended that a written lease be completed for a homestead quarter.

#### **Written Lease**

A lease for a term exceeding three years to be enforceable is required by the Statute of Frauds to be in writing. When a lease is written, it should state all the terms and conditions because any verbal promises given in addition to the written agreement may not be binding.

Although a written lease exceeding three years is binding on the existing landlord and tenant it should be registered with the Land Titles Office to ensure that it shall be valid and enforceable if the property is sold to a new owner.

### **The Land Titles Act, 2000 and The Landlord and Tenant Act (Provincial)**

These two Acts outline among other things, all the implied obligations by the landlord and tenant unless they have been specifically excluded in a written agreement. These include the following:

- i. The tenant will pay the rent agreed to in the lease.
- ii. The tenant can peaceably possess and enjoy the property for the term of lease without interference from the landlord.
- iii. The tenant is obligated to make repairs and to maintain the property in the same condition in which he took it except for reasonable wear and tear, and damages arising from natural hazards.
- iv. The landlord or his agent can enter upon the leased land to inspect the rented property. He may also request in writing that the tenant make specified repairs within a reasonable time period.
- v. Where the tenant is in default of payment or any other condition of the agreement for a period of two months, the landlord may repossess and occupy the rented property.

### **The Homesteads Act 1989(Provincial)**

This Act requires that the landlord's non-owning spouse give written consent (Consent of Non-Owning Spouse) to every lease agreement involving the homestead parcel. A "Homestead" is any land(s) upon which the spouses have lived since their marriage in which the owning spouse has an equity interest. A person may have several homesteads. The Act also requires that the non-owning spouse appear before a solicitor, notary public, justice of the peace, or court judge to have "The Certificate of Acknowledgement" completed. This is to ensure that the non-owning spouse understands his/her rights in the homestead and that he/she signs the lease agreement and "Consent of Non-Owning Spouse" of his/her own free will and consent and without any compulsion on the part of the owning spouse. The "Affidavit of the Landlord" should be completed if the landlord has no spouse, or if the land in the Agreement has never been part of a homestead, or if the landlord's spouse's Homestead Rights were relinquished by an interspousal agreement or Court Order pursuant to *The Matrimonial Property Act*.

### **Registration of a Lease**

In order to ensure that a lease is valid and enforceable against a purchaser, a lease exceeding three years must be either recorded on the certificate of title as a "lease registration" or recorded by means of a "caveat". Leases for a term not exceeding three years, where the tenant is in actual occupation of the land, do not have to be registered at the Land Titles Office to be enforceable against a purchaser. The onus is therefore on the purchaser to ensure the property has not been rented out under a short term lease, by making inquiries in the district to determine who farmed the land last year.

The *Land Titles Act* does not make any provision for the registration of a lease which has a term of three years or less. In addition, "Lease Registration" is not permitted in situations where the land is controlled by the landlord under an agreement for sale or the written agreement does not conform to the required format. In these situations, the tenant's interest can be protected by filing a caveat on the certificate of title.

A fee is charged by the Land Titles Office for a lease registration. Land Titles Offices are located in Battleford, Humboldt, Moose Jaw, Prince Albert, Regina, Saskatoon, Swift Current, and Yorkton.

### **Removal of a Lease Registration**

After a registered lease has expired, the landlord naturally wishes that it be cancelled from his title. This can be done by having the tenant complete a "Surrender of Lease" form and by registering it in the appropriate Land Titles Office.

Leases which are registered by way of "caveat" on a certificate may be removed by the method outlined in the section "Removal of a Caveat".

When a lease that was registered expires, the landlord may request the Registrar of Land Titles to remove the lease registration. This is done by the Registrar serving a notice lapse to the tenant. If the tenant does not file a notice with the Registrar within thirty days that he still has an interest in the land, the lease registration will lapse.

### **Caveat**

The word caveat means "to be aware". Caveats are registered by parties who have or claim they have acquired some interest in land under a document that cannot be registered. This would include a leasehold interest in buildings. Any dispute which may arise with respect to such claims may have to be resolved by the Court.

The caveat can be recorded on the Certificate of Title by sending the caveat in the form prescribed to the Land Titles Office together with the required fee.

Any person finding a caveat recorded on the title should be on his guard before purchasing the property. He should find out what the caveat is all about before completing the purchase.

### **Removal of a Caveat**

The caveat can be removed by the tenant completing a "withdrawal and discharge of caveat" and sending it to the appropriate Land Titles Office. There is also a procedure in *The Land Titles Act* for the landlord to seek the removal of the caveat by a process called lapsing.

### **Permanent Improvements**

Permanent Improvements such as buildings, fences, wells, dugouts, clearing and breaking, which are made by the tenant become part of the land and therefore are legally owned by the landlord unless there is an agreement to the contrary. Prior to making permanent improvements the tenant should have written permission from the landlord. It should clearly outline what buildings or improvements are to be made, who will pay the cost of materials and how the tenant will be compensated at the termination of the lease for his labour or any costs which he may incur. The tenant could be compensated in the following ways:

- i) reduced rental,
- ii) cash payment based on the market value of the improvement at the termination of the lease, and
- iii) longer term lease with no increase in the rental.

In situations where a son erects a building (e.g., hog barn) on his father's land the same legal implications apply. To protect his interest in the building the son should complete a leasehold agreement with the father and file a caveat against his father's title. This would warn potential purchasers that a tenant has an interest in the property which must be honoured.

### **Crop Insurance**

Only actual producers are eligible to hold a crop insurance contract. Landlords are not able to participate directly. Landlords and tenants that enter into a lease can negotiate and agree with respect to sharing premium costs and program benefits.

In other agreements such as custom hiring agreements, joint farming venture agreements and partnership agreements, the landowner is considered a farmer (producer) by Revenue Canada and Saskatchewan Crop Insurance Corporation.

Planning is required to incorporate crop insurance into a lease agreement which accommodates the needs of both landlords and tenants.

### ***The Agricultural Leaseholds Act***

Situations can arise whereby the tenant is unable to harvest the crop or remove stored grain from the rented land before termination of the lease. This includes bad weather conditions, lack of grain storage facilities and conditions which prevent the sale of grain.

The *Agricultural Leaseholds Act* outlines the conditions under which a tenant may re-enter upon the land to harvest a crop and remove the stored grain. Where harvesting was completed before termination of the lease but grains remained stored on the rented property, the tenant must give written notice to the owner or occupant of the land at least seven days prior to re-entering but not later than June 1 following termination of the lease. The written notice must specify the nature and extent of the work to be carried out and the approximate date of re-entry which must not be later than June 15. Removal of the stored grain must be completed by June 30.

Where re-entry is made by the tenant to complete the harvest, written notice at least seven days prior to re-entry but not later than April 1 of the year after termination of lease must be given to the occupant or where the land is unoccupied to the owner. The notice must also specify the nature and extent of work to be carried out and the approximate date of re-entry which must not be later than May 1 following the date of termination of the lease. The tenant shall complete the harvesting and withdraw from the land not later than May 15.

The conditions as specified in the *Agricultural Leaseholds Act*, apply to any agricultural land lease between private parties.

## Termination of Leases

The following are situations in which a lease may be terminated:

- i) A lease terminates automatically at the end of the term. When the term of a lease expires but the tenant continues possession of the property, the landlord can take action under the *Landlord Tenant Act* to have the tenant removed.
- ii) A tenant may surrender a lease. Procedures for surrendering a lease that has been registered at Land Titles are provided for in *The Land Titles Act*.
- iii) When the landlord sells the property to the tenant, the lease is terminated. If the tenant had registered the lease by means of a lease registration or caveat, then the lease registration or caveat must be discharged by the tenant in the usual way.
- iv) A lease is terminated when a party holding a mortgage (mortgagee) on the land, granted prior to the lease, forecloses and the mortgagee had not originally consented to the renting of the property to the tenant.
- v) Termination can occur by the landlord issuing a notice to quit to the tenant. A notice to quit is used when a lease does not expressly state a termination date or where a tenancy has arisen by implication of law. Unless the lease provides otherwise, six months' notice prior to the anniversary date of commencement of a lease is the usual requirement for termination. However, this may vary depending on the type of tenancy.
- vi) A landlord could cancel the lease and take action under the provisions of *The Landlord Tenant Act* to repossess the property for breach of contract by the tenant. Breach of contract most normally occurs if rent is not paid. Breach of contract for poor farming practices or other reasons are more difficult to prove unless the lease agreement clearly states the responsibilities of the tenant.
- vii) When land is sold to a third party by the landlord, the lease cannot be enforced by the tenant against the new landlord unless the tenant has registered the lease or a caveat at the Land Titles Office. However, a lease three years or less in length can be enforced by the tenant in actual occupation of the land.

**Appendix I**

**1. Contributions Approach**

**Landlord's Cost Per Cultivated Acre**

Land Investment Cost:  
 \$ \_\_\_\_\_ per acre x \_\_\_\_\_ %      \_\_\_\_\_

Buildings Investment Cost:  
 \$ \_\_\_\_\_ per acre x \_\_\_\_\_ %      \_\_\_\_\_

Depreciation:  
 \$ \_\_\_\_\_ per acre x \_\_\_\_\_ %      \_\_\_\_\_

Repairs \_\_\_\_\_  
 Property Taxes \_\_\_\_\_  
 Other Costs \_\_\_\_\_

**A. Landlord's Total Costs:  
 Per Cultivated Acre**      \_\_\_\_\_

**Tenant's Cost Per Cultivated Acre**

Seed and Seed Related Cost \_\_\_\_\_  
 Fertilizer \_\_\_\_\_  
 Taxes \_\_\_\_\_  
 Chemical \_\_\_\_\_  
 Crop Insurances \_\_\_\_\_

Machinery Investment Cost:  
 \$ \_\_\_\_\_ per acre x \_\_\_\_\_ %      \_\_\_\_\_

Depreciation:  
 \$ \_\_\_\_\_ per acre x \_\_\_\_\_ %      \_\_\_\_\_

Repairs \_\_\_\_\_  
 Fuel and Lubricants \_\_\_\_\_  
 Miscellaneous \_\_\_\_\_  
 Labour \_\_\_\_\_  
 Interest \_\_\_\_\_

**B. Tenant's Total Costs:  
 Per Cultivated Acre**      \_\_\_\_\_

Total Cost Contributed A + B = \$ \_\_\_\_\_

Landlord's Share (A/ (A+B)) x 100 = \_\_\_\_\_ %

Tenant's Share (B/ (A+B)) x 100 = \_\_\_\_\_ %

Note: (i) Do not include costs which are to be shared in the same proportion as the share of crop (e.g. fertilizer, wild oat spray)

(ii) If land taxes or repairs on the landlord's buildings are paid by the tenant, these should be included with the tenant's costs. Similarly, if the landlord supplies machinery, the investment and depreciation costs should be added to the landlord's costs.



**2. Income Approach Worksheet (for use by a tenant and/or landlord)**

Expected Income								
Crop	Acres	x	Yield	x	Price	=	Income	My Share
Other Income								
<b>Total Expected Income (A)</b>								

**Estimated Extra Crop Input Costs**

Crop Input Costs	Total	My Share
- Seed		
- Fertilizer		
- Chemicals		
Total Crop Inputs (B)		
Estimated Extra Cash Costs	Total	My Share
Building Repairs		
Machinery - fuel, lubrication		
- repairs and maintenance		
Crop and Hail Insurance		
Property Taxes		
Custom Work Hired		
Hired Labour		
Rent (if a cash rent)		
Interest on Operating Capital		
Extra Machinery Depreciation		

= $\frac{\text{orig. cost} - \text{salvage value}}{\text{years of use}} = \underline{\hspace{2cm}} - \underline{\hspace{2cm}}$		
Extra Machinery Investment Cost		
= $\frac{\text{orig. cost} + \text{salvage value}}{2} \times \text{int. rate} = \underline{\hspace{2cm}} + \underline{\hspace{2cm}} \times \underline{\hspace{2cm}}\%$		
Extra Machinery Insurance		
Other Costs:		
<b>Total Extra Cash Costs (C)</b>		
<b>Total Extra Costs (B+C)</b>		
<b>Return Above Extra Costs (A-B)</b>		

<b>Appendix II</b>		<b>The Contribution Approach</b>	
<b>Pasture land</b>			
<b>Pasture Owner's Costs:</b>		\$ /cow	
Pasture (A)		\$ _____	
<b>Cow/Calf Producer's Costs:</b>			
<b>Operating Costs</b>			
Feed		\$ _____	
Bedding		\$ _____	
Veterinary and Medicine		\$ _____	
Breeding		\$ _____	
Herd Replacement		\$ _____	
Death Loss		\$ _____	
Marketing		\$ _____	
Fuel, Lube and Repairs		\$ _____	
Manure Removal		\$ _____	
Facility and Fence		\$ _____	
Miscellaneous		\$ _____	
Subtotal Operating		\$ _____	
Operating Interest		\$ _____	
Total Operating Costs		\$ _____	
<b>Fixed Costs</b>			
Facilities		\$ _____	
Equipment		\$ _____	
<b>Interest on Investment</b>			
Facilities		\$ _____	
Equipment		\$ _____	
Breeding Herd ( _____ cows x \$ _____ + _____ bulls x \$ _____ ) x 5% / _____ cows		\$ _____	
<b>Total Fixed Costs</b>		\$ _____	
Labour and Management		\$ _____	
<b>Total Producer's Costs (B)</b>		\$ _____	
<b>Total All Costs (C)</b>		\$ _____	
<b>Pasture Owner's Share = <math>\frac{\\$ (A)}{(C)} \times 100 = \text{_____} \%</math></b>			
<b>Producer's Share = <math>\frac{\\$ (B)}{(C)} \times 100 = \text{_____} \%</math></b>			