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# Crop Share Lease Agreements

Burton Pflueger
*South Dakota State University*

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Burton Pflueger, Extension economist

Any lease is basically an agreement that gives the use of an asset to a lessee for a specific period of time at a specified rate. A lease does not transfer title of ownership nor an equity interest in the asset.

Labeling a document as a lease does not necessarily mean it is a lease according to the Internal Revenue Service (IRS). This Extension Extra does not address any of the questions concerning the IRS treatment of a lease; if you have questions you should contact their tax management professional. Also, this Extra does not address any questions concerning the legalities of the lease that should be addressed by professional legal counsel.

## Crop Share Lease

A crop share lease agreement differs from a cash lease agreement in that the crop share agreement does not provide for a specified amount of cash rent to be paid to the landlord. Instead, the crop share agreement provides for specified percentages of the crop to go to the landowner and the tenant. The basic premise is for each party to receive income from the crop in proportion to what each party contributes to production.

**Advantages** of a crop share lease agreement over other types of agreements include:

1. Less operating monies may be tied up by the tenant due to the landowner sharing some production costs.
2. Management may be shared between an experienced landowner and tenant, resulting in more effective and financially rewarding decisions.
3. Crop sales and input purchases may be timed for improved tax management.
4. Risks of low yields and prices are shared between the two parties. Profits from high yields and/or prices are also shared.
5. Landowner "material participation" may be more easily proved for use of government programs, estate purposes, building social security base, and income tax purposes than under the various cash rental agreements.

**Disadvantages** of a crop share lease agreement over other types of agreements include:

1. Landowner income will be variable because of yield and price variations as well as changes in costs of shared inputs to production.
2. Accounting for shared expenses must be maintained.
3. The landowner must make marketing decisions.
4. Landowner and tenant must discuss annual cropping practices and other management issues.
5. As prices change, the lease should be reviewed for fairness. Sharing agreements may also need to be changed.

## Developing A Fair Crop Share Lease Agreement

Farming is a business in which land, labor, and capital are combined through the application of management. When any of these factors are owned or contributed by different parties, the payment for each factor should be equal to its value as an input to production. The crop share lease agreement should be developed based on the answers to two primary questions: (1) How should the costs of inputs be shared? (2) How should the harvested

crop be shared to provide compensation for what the party has contributed to producing that crop?

In a typical crop share lease agreement, the landowner contributes land and improvements, associated property expenses, and a certain share of the variable costs. The tenant usually contributes machinery, associated equipment expenses, and a certain share of the variable costs.

Development of any final arrangements of the lease should be based on identifying all contributions of each party. Examples of how to use farm enterprise crop budgets to identify the contributions of the landlord and tenant and develop a crop share lease agreement are included at the end of this Extra.

Valuing land is very difficult. Land costs represent a high proportion of total costs, and land usually appreciates in value over time. Land values should be based on fair market value for agricultural purposes with adjustments made for property taxes and insurance. Readers interested in current South Dakota agricultural land values can consult the SDSU publication C271, Agricultural Land Market Trends 1991-2006, South Dakota State University, which can be found on the internet at http://agbiopubs.sdstate.edu/articles/C271.pdf

Buildings and improvements should be evaluated on their contribution to the farming operating. Sometimes cash rent is charged for buildings.

Machinery and equipment normally have a multi-year life, so their cost should be spread over several years. Contributions are often based on depreciation, taxes, insurance, repairs, housing, and some return on the investment. Custom rates for anticipated operations are sometimes used when other machinery and equipment costs are unknown.

Management is an important contribution to a successful lease arrangement. Its value is often a bargaining proposition between the involved parties. Management may be valued as a percentage of gross returns, rate per unit of yield, or percentage of all non-land costs.

Variable expenses can be classified into three categories and should be shared according to their classification: yield increasing, true substitution, or both. Variable expenses which are yield increasing should be shared in the same percentage as the crop share. Such sharing encourages the parties to use the amount of input which will maximize net returns to the total operation.

Substitution inputs are those that replace another input, such as chemical weed control replacing cultivation. Often new technologies make substitution inputs available to the production process. Substitution inputs may cause yields to increase and/or be used to replace a currently used input. True substitution items should be paid by the party responsible for the item in the original lease. Items that both cause yield increases and are true substitution items are good reasons for redeveloping the lease.

Irrigation costs may involve special problems, so the landowner and tenant should be careful when agreeing who is paying for which irrigation expenses. While government program payments are usually shared in the same proportion as the crop, the tenant normally takes care of tillage, seeding, and weed control on "set-aside" acreage.

Factors other than the relative contributions to production costs may affect rental agreements. Crop share percentages tend to become accepted as custom; hence, they are not easily changed. Also, local supply and demand conditions for rented land may affect the agreement.

### Put the Agreement in Writing

Both landlords and tenants are reminded that it is highly desirable to put the terms of a lease agreement in writing. A written lease agreement enhances understanding and communication between all involved parties, serves as a reminder of the terms originally agreed upon, and provides a valuable guide for the heirs if either the landowner or tenant dies.

For some types of lease agreements, such as leases for longer than one year, South Dakota Codified Laws specify that the lease be written. Consult your attorney for guidance. Sample lease forms can be found elsewhere in this publication series.

## Example 1. Crop Share Lease Arrangement Calculations

| | *Soybeans* | | |
|---|---|---|---|
| **Gross return** | | | |
| Estimated yield | 40 | | |
| Estimated selling price | $ 5.00 | | |
| Value per acre | $ 200.00 | | |
| Other income per acre | | | |
| **Gross return per acre** | $ 200.00 | | |
| | | *Landlord contribution* | *Tenant contribution* |
| **Direct costs per acre** | | | |
| Seed | $ 32.66 | | $ 32.66 |
| Fertilizer | 17.50 | | 17.50 |
| Herbicide | 15.00 | | 15.00 |
| Insecticide | 5.00 | | 5.00 |
| Fungicide | 7.00 | | 7.00 |
| Crop insurance | 8.00 | | 8.00 |
| Machinery costs (operating) | 16.77 | | 16.77 |
| Custom hire | - | | - |
| Drying | | | |
| Operating interest | 4.63 | | 4.63 |
| Other variable costs | | | |
| **Total direct costs per acre** | $ 106.56 | | $106.56 |
| Machinery (ownership costs) | $ 26.44 | | $ 26.44 |
| Land charge | $ 55.00 | $ 55.00 | |
| Total costs per acre | $ 188.00 | $ 55.00 | $133.00 |
| **% total costs per acre** | | 29.2554 | 70.74462 |

For this example, the landlord and tenant may agree to split the harvested crop on a 70% to the tenant and 30% to the landlord just to simplify the calculations.

## Example 2. Crop Share Lease Arrangement Calculations

| | *Corn* | | |
|---|---|---|---|
| **Gross return** | | | |
| Estimated yield | 140 | | |
| Estimated selling price | $ 2.00 | | |
| Value per acre | $280.00 | | |
| Other income per acre | | | |
| **Gross return per acre** | **$280.00** | | |
| | | *Landlord contribution* | *Tenant contribution* |
| **Direct costs per acre** | | | |
| Seed | $ 50.00 | | $ 50.00 |
| Fertilizer | 54.80 | | 54.80 |
| Herbicide | 20.00 | | 20.00 |
| Insecticide | | | |
| Fungicide | | | |
| Crop insurance | 10.00 | | 10.00 |
| Machinery costs (operating) | 22.55 | | 22.55 |
| Custom hire | | | |
| Drying | 8.75 | | |
| Operating interest | 8.01 | | 8.01 |
| Other variable costs | | | |
| **Total direct costs per acre** | $174.11 | | |
| Total direct costs per acre less drying cost | $165.36 | | $ 165.36 |
| **Total direct costs per acre contributed** | | | |
| Machinery (ownership costs) | $ 30.12 | | $ 30.12 |
| Land charge | $ 55.00 | $ 55.00 | |
| Total costs per acre | $259.23 | | |
| Total costs per acre less drying | $250.48 | $ 55.00 | $ 195.48 |
| **% total costs per acre** | | 21.9576 | 78.0424 |
| Drying | 8.75 | 1.92 | 6.83 |
| | | $ 56.92 | $ 202.31 |
| | | 21.96 | 78.04 |

In this particular example, drying costs are directly related to the amount of crop harvested. Landlord and tenant would share drying costs based on the share of the crop that each received. Thus the drying costs are removed from consideration until after the percentage of crop to each party has been determined.

For this example, the landlord and tenant may agree to split the harvested crop onn 80% to the tenant and 20% to the landlord just to simplify the calculations.

## Crop Share Lease Arrangement Calculations Worksheet

| | *Crop* |
|---|---|
| **Gross return** | |
| Estimated yield | _____ (bushels, tons, etc.) |
| Estimated selling price | $ _____ |
| Value per acre | $ _____ |
| Other income per acre | |
| **Gross return per acre** | $ _____ |

| | *Total expense per acre, $* | *Landlord contribution, $* | *Tenant contribution, $* |
|---|---|---|---|
| **Direct costs per acre** | | | |
| Seed | _____ | _____ | _____ |
| Fertilizer | _____ | _____ | _____ |
| Herbicide | _____ | _____ | _____ |
| Insecticide | _____ | _____ | _____ |
| Fungicide | _____ | _____ | _____ |
| Crop Insurance | _____ | _____ | _____ |
| Machinery costs (operating) | _____ | _____ | _____ |
| Custom hire | _____ | _____ | _____ |
| Drying | _____ | _____ | _____ |
| Operating interest | _____ | _____ | _____ |
| Other variable costs | _____ | _____ | _____ |
| **Total direct costs per acre** | $ _____ | $ _____ | $ _____ |
| Machinery (ownership costs) | _____ | _____ | _____ |
| Land charge | _____ | _____ | _____ |
| **Total costs per acre** | $ _____ | $ _____ | $ _____ |
| **% of total costs per acre** | **100%** | _____ % | _____ % |

Adapted for South Dakota from Crop Share Lease Agreements, Agriculture & Business Management Notes, Section 4, No.4.6,Cooperative Extension, Colorado State University

Crop enterprise budgets used in examples on page 3 can be found at http://econ.sdstate.edu/Extension/ in the Management Tools and Links section.


EXEX5065. 2007. Access at http://agbiopubs.sdstate.edu/articles/ExEx2065.pdf.