

A Legal Guide



to the Business of

Farming in Vermont



A LEGAL GUIDE TO THE BUSINESS OF FARMING IN VERMONT

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Introduction

This legal guide began its life as a seven-page outline on the “Legal Terrain” delivered to a Tilling the Soil of Opportunity business planning class in Berlin, Vermont, on a very cold evening in February of 2003. Tilling the Soil is a 10-session course offered by UVM Extension, Land Link Vermont, Vermont Small Business Development Center, and other partners. It provides new and experienced farmers the opportunity to explore innovative farm start-up or diversification strategies and to develop a “lender ready” business plan, www.nxlevel.org. The sessions address everything from marketing and farm cash flow to legal issues and risk management.

The topics addressed in the Legal Terrain session are largely participant driven. Questions submitted by participants have covered a wide swath of issues including farm labor, land use, non-traditional legal structures, farm leases, and farm transfer. The questions posed by the Tilling participants informed our initial outline of the Guide as well as the core of the Guide’s contents.

Despite its roots in a business planning class for farmers, this publication is primarily intended for

use by Vermont farm service providers – Extension, land trust, farm agency personnel, attorneys, and others who work directly with farmers on farm start-up, farm viability, or farm transfer issues. The guide is a reference tool. It can be used by service providers to develop case specific checklists and to identify areas that need additional research or technical assistance. The issues addressed by farm service providers in Vermont are complex and inter-related. The guide should be useful to service providers trying to cover all the bases.

General publications and websites that address many of the issues covered in this guide are widely available. Most land grant institutions provide excellent fact sheets on farm transfer, farm tax, and other legal issues, for example. What this guide contributes is the “Vermont layer.” An accurate assessment of the applicability of labor regulation on Vermont farms, for example, requires an analysis of both Vermont and federal law. Vermont’s Medicaid rules and their implications for farm transfer strategies are also specific to Vermont. Many of the land use issues such as Act 250, “current use,” and our own right-to-farm law are

all specific to Vermont. In this respect, the Guide fills an important gap. Every state should be so lucky. We are very grateful to SARE for funding this publication.

Farmers and “Tilling the Soil” participants will also find this guide useful. However, **farmers should not use this guide as a substitute for legal advice.** Instead, it is a useful resource when developing a list of questions for an attorney, accountant, or farm service provider. Farmers may also use it to identify and address issues that need to be included in the farm’s business plan or to become better informed consumers of legal or farm viability services. But, always, use it in conjunction with a farm service provider.

As a last caution, users of the Guide - as a matter of habit - are advised to always go to the original sources cited in the guide to ensure that the law has not been changed. This is important because laws and regulations change frequently. Vermont statutes are available at: <http://198.187.128.12/vermont/lpext.dll?f=templates&fn=fs-main.htm&2.0>. Federal statutes are located at: <http://www.law.cornell.edu/uscode/>. The federal code of regulation is at: <http://www.law.cornell.edu/cfr/>.



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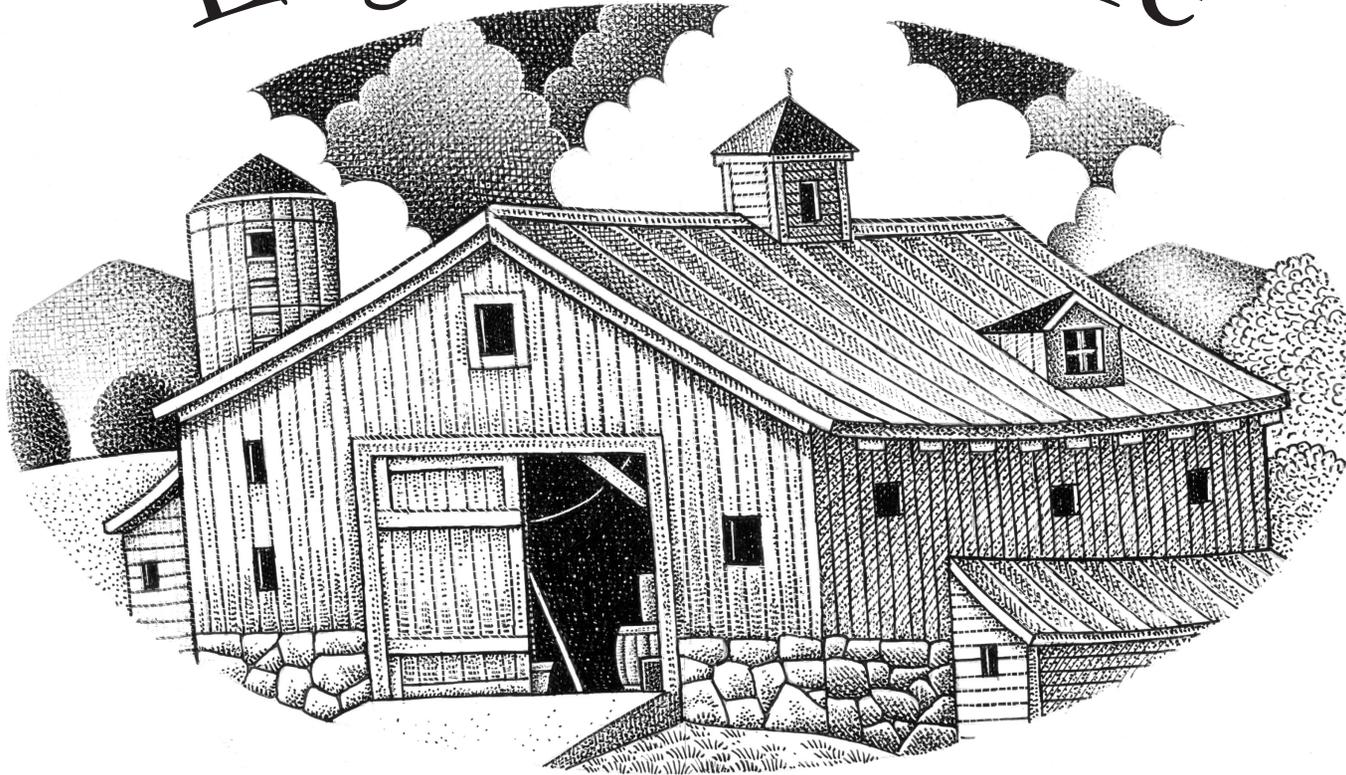
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Legal Structure



of the Farm Business

By Annette Higby



LEGAL STRUCTURE OF THE FARM BUSINESS

In Vermont, most farms are sole or family proprietorships. According to the 2002 Agriculture Census, 88 percent of Vermont's farms are sole proprietorships, while 7 percent operate as partnerships, and 4 percent fall under a corporate structure. Only 1 percent of Vermont farms fall under the "other" category, which includes cooperatives, trusts,

estates, and limited liability companies, or LLCs.¹ However, LLCs appear to be the fastest growing category in Vermont. LLCs have been permitted by Vermont law only since 1996,² but as of January 1, 2004, there were 7,258 LLCs in the state. Any farmer who is starting a new on-farm enterprise, looking for a way to transfer assets to

the next generation, reevaluating exposure to liability, or at some other important juncture in the life of the farm business needs to consider the most appropriate legal structure for achieving these goals.

When choosing a business structure for a new or evolving farm operation, it's wise to consider a number of factors.

Choice of Entity

Type of Entity	Limited Liability	Taxation	Ease of Transfer	Raising Capital
Sole Proprietorship	No	Taxed as an individual	Transfer of individual assets	Less appropriate
General Partnership	No, but may elect to become a limited liability partnership.	Partnership taxation	Transfer of capital interest	Appropriate where structured as a limited partnership
Limited Liability Company	Yes	May choose to be taxed as a partnership or as a corporation. Single member LLC is a "disregarded entity."	Transfer of units	Yes
Corporation	Yes	May choose to be taxed as a Partnership (S Corp) or as a Corporation (C Corp.)	Transfer of shares	Yes
Non-Profit Corporation	Limited Liability for members and uncompensated board members.	Tax exempt	Transfer of assets to other than another non-profit is prohibited.	Yes
Cooperatives	Limited Liability for Members	Taxed as a cooperative	Transfer restricted to other eligible cooperative members (farmers).	Yes



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Important Factors for Choosing an Entity

Taxation

Business taxation falls into three categories, as described below.

1. Pass-through entities. In a pass-through entity, income and expenses for the business are reported to the IRS, but tax liability “passes through” to the individual owners of the business and is based on their share of the business. Partnerships, for example, provide an informational return to the IRS, but the individual partners report and pay tax on their share of the partnership income.

2. The double-taxation entity. Some entities pay tax on business income. However, owners who receive that income as dividends pay taxes on it again. Corporations, for example, pay tax on corporate income when they are taxed as corporations, but shareholders also pay a tax on the corporate dividends that the corporation paid to them.

3. Disregarded entities. Some entities, such as one-member LLCs, are “disregarded entities.” The IRS disregards the entity entirely and taxes the owner directly. Certain kinds of trusts are also disregarded entirely by the IRS and all income is taxed directly to the owner or “settlor,” the person who creates a trust.

With a few exceptions, this chapter will cover only basic information about farm entity taxation.

Farmers should always discuss the tax consequences of any choice of entity with a tax professional before the entity is formed. It’s also a good idea to have the tax professional review the operating or partnership agreement. Farmers should have a clear understanding of the tax treatment of the business at every stage of the business – from formation to liquidation. A tax professional can also help farmers track their tax basis in any assets transferred to a new entity as well as inform them if a transfer of assets into a new entity will generate an income or capital gain tax.

Taxation seems to be the dominant consideration for many people when they choose a particular entity. Tax law, however, often allows a choice of taxation options for the entity chosen. Corporations, for example, may choose to be taxed as a double-taxation entity – a C Corporation – or a pass-through entity – an S Corporation. LLCs also have this choice. While farmers need to understand the tax rules, taxation shouldn’t be the tail that wags the dog. Other considerations are equally, if not more, important in choosing the most appropriate entity for the farm business.

Limited Liability

Corporations, limited liability companies, limited liability partnerships, and agricultural cooperatives all provide limited liability to their shareholders, members and partners. The limited partners of

limited partnerships and the members and uncompensated directors of non-profit corporations also enjoy limited liability. Limited liability means that a stakeholder’s financial risk in an enterprise is limited to his or her investment in the enterprise.

The public purpose behind limited liability is to encourage people to take risks with their

Factors to Consider in Choosing an Entity

- **Taxation.** Will the entity be taxed like a partnership or like a corporation?
- **Limited Liability.** Will the owners of the business be personally liable for the debts and obligations of the farm business?
- **Ease of Transfer.** Does the entity structure make it easy to track and transfer ownership interests in the business to the next generation?
- **Life of the Entity.** When does the entity terminate? Will the entity continue beyond the life of one or all of its owners?
- **Raising Capital.** Does the entity allow for outsiders to invest in the business?



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capital and to foster economic growth. For many small business owners, limited liability shields the family home, the retirement account, and other personal assets from the financial risk of the business. But in the farm context, the line between business and personal assets is not so neat. The farm is usually the family's home, and the farmland its retirement plan. If the entire farm is put into a limited liability entity, everything is at risk. Unless there are significant non-farm assets, it may not make sense to put the entire farm into one limited liability entity. More often, it makes sense to put the farmland into one entity and the farm operation into another entity. Or, a new on-farm enterprise can be contained in a separate limited liability entity to shield the farm from the financial risk of a new enterprise.

The Limits to Limited Liability

Limited liability will not shield a business owner or an employee from personal liability for his or her own negligence. If an employee negligently causes an automobile accident while working for an LLC, there are three potential defendants. The employee may be held personally liable for the action. The LLC can also be held liable because the employee was working for it. The employer may also be held personally liable if he or she was negligent in hiring or supervising the employee. Similarly, if a member of an LLC negligently causes an automobile accident while working for the LLC, liability will fall on both the business and the member.

Secured Creditors and Other Contractual Exceptions to Limited Liability

Limited liability will not prevent a member or shareholder from agreeing to be held personally liable for the debts or other obligations of the entity. In fact, most creditors, lessors, and other parties will insist on personal liability for the debt or other obligations of the contract.

Secured creditors, in particular, will most likely ask members or partners to remain personally liable on their note and may also ask them to pledge non-farm assets as security for the loan.

Losing the Liability Shield

Once a liability shield is obtained, certain steps must be taken to maintain it. Courts may disregard the liability shield — or pierce the corporate veil — and allow plaintiffs, unsecured creditors, or other claimants to reach the personal assets of the owners of the business under certain sets of facts. Most of the cases³ that address piercing the corporate veil involve the corporate form, but courts have been applying the same rules to limited liability companies and other limited liability entities. The two primary ways to lose the liability shield include disregarding the entity and inadequate capitalization.

Disregarding the Entity

Courts often remove the shield of limited liability in cases where owners fail to treat the business as a separate entity. Co-mingling business funds with personal funds or failing to prepare corporate resolutions or document business transactions be-

tween the entity and its owners, for example, are all factors a court might use to pierce the corporate veil. It is especially important in a family setting to document with leases, promissory notes, and other documentation transactions between family members and the family entity.

A liability shield is also put at risk in cases where the members or shareholders lead others to believe they are dealing with them personally rather than with a separate entity with a limited liability shield. You must include "LLC," "Inc.," or some other indication of limited liability on the business checks or letterhead. By statute in Vermont, the business name must include words such as "corporation," "incorporated," "company," "limited, corp. co.," or "Ltd."⁴

Undercapitalization

Courts are especially inclined to let creditors reach personal assets when the assets in the business are inadequate to meet the ordinary and expected obligations of the business. If a business is not much more than an empty check book, a court will likely look to the personal assets of the owner. Adequate capitalization also means having adequate insurance.

Limited liability entities can make themselves vulnerable by making distributions of income or assets that lead to inadequate capitalization. By statute in Vermont, for example, members of LLCs are prohibited from making distributions that leave the entity thinly capitalized. "Thinly capitalized" means that capital is inadequate to



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meet obligations as they become due in the ordinary course of business, plus the costs of dissolution. If a prohibited distribution is made, members will be personally liable up to an amount by which the distribution exceeds necessary capitalization.⁵ This prohibition includes loans or other transfers of assets to shareholders or members that lead to insolvency.

Ease of Transfer

Another factor that drives the choice of entity or a conversion from one entity to another is ease of transfer. How easily will a particular legal structure facilitate a lifetime transfer to the next generation? Legal structures that reduce the farm to “units” or “shares” can simplify farm transfer. Certain legal structures make it easier to value, track, and transfer an interest in a farm business. In an LLC, for example, the senior generation can transfer a number of units each year to the junior generation, gradually transferring the business. Partnerships that track the partners’ “capital accounts” on an annual basis can also gradually transfer equity to the junior generation. In contrast, a sole proprietorship can’t easily make a lifetime transfer of farmland a few acres at a time. It is more difficult to make lifetime gifts of an interest in a sole or family proprietorship than it is to transfer shares in a corporation or membership units in a limited liability company. It is also

easier to use the latter two structures to transfer an economic interest while retaining or gradually transferring control over the asset.

These issues are described in more depth in “Transferring an Interest in a Farm Business” on page 37 of Chapter II, Farm Transfer and Estate Planning.

Special Duties and Authority to Make Business Decisions

Members of multi-member entities often have an extra set of obligations that they owe to their business partners, for example: duties of good faith, fair dealing, and loyalty. The rules regarding who can speak for and bind the company also vary depending on the entity type.

Nature of the Business and the Business Assets

Some businesses present more financial risks than others. A new enterprise that lacks data about markets or other considerations that can help to predict success is financially risky. The purpose of the limited liability shield is to encourage entrepreneurs to take risks with their capital. If the business is operating in an untested market, a limited liability shield — to contain that risk — makes a lot of sense.

If assets are appreciating rapidly, it may be wise

to put them into an entity that allows you to begin moving them out of the estate to reduce liability for future estate taxes. If, on the other hand, it is a low-basis asset, then the capital gain consequences of a lifetime gift must be weighed against the potential for estate taxes.

Life of the Entity

A sole proprietorship ceases upon the death of the sole proprietor. Corporations, on the other hand, can conceivably last into perpetuity. Other entities can exist for a “term of years” or “at will,” meaning that members can terminate the entity at any time. Most partnership or operating agreements provide for rights to purchase from a deceased estate in the event of death and life insurance to fund it. Where farm transfer is contemplated, an entity that will outlive the senior generation may make the most sense.

Raising Capital

Some entities are more appropriate than others if you want to attract capital investors — LLCs, corporations, cooperatives, and limited partnerships are a few entities that are especially structured to facilitate the use of outside capital. Entities that seek outside capital must also comply with the rules regarding the sale and registration of securities. For more on securities regulation, see “Raising Capital Using the LLC Structure” on page 28.



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The Sole Proprietorship

Advantages and Disadvantages of Sole Proprietorships

Advantages

- Simple ownership and taxation rules
- Inexpensive to form
- Well understood by the public
- Retention of the homestead exemption

Farmers who decide to operate their business as a sole proprietorship are in good company; the majority of farms in Vermont operate as a sole or family proprietorship. The sole proprietorship is the essence of simplicity. The sole proprietor owns, manages, and is responsible for paying taxes on all income earned by his or her business. All income, losses, credits, and deductions are reported on the sole proprietor's personal income tax return. The business identification number can be his or her social security number. However, if the business has employees, the sole proprietor must apply for an Employer Identification number from the IRS. (For an on-line application go to: <http://www.irs.gov/businesses/small/article/0,,id=102767,00.html>.) The sole proprietor bears the full risk of financial

Disadvantages

- No liability shield – all non-exempt personal assets are at risk
- Farm transfer can be cumbersome
- Business terminates at death of owner unless an estate plan is in place

failure, with both business and personal assets on the line. But the sole proprietor also has sole control of business decisions and owes no duty to partners or others in the business.

When the sole proprietor dies, the business terminates, although business assets may be left to an heir by will or in a trust.

A sole proprietor in Vermont may choose to operate under a trade name. To operate under a trade name, "ABC Farms," for example, the farmer must register that name with the Vermont Secretary of State's office for a fee of \$40.00. The trade name must be different from, and not deceptively similar to, another registered trade name or other registered corporation, partnership, or limited liability company.⁶ The trade name registration database is available on line at: <http://www.sec.state.vt.us/seek/tradseek.htm>.

“**The majority of farms in Vermont operate as a sole or family proprietorship. The sole proprietorship is the essence of simplicity.**”



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The Farm Partnership

Advantages and Disadvantages of Farm Partnerships

Advantages

- Well understood in the farming and non-farming community
- Pass-through taxation
- Simplicity of operation
- Inexpensive to set up
- Most generous entity for federal farm program purposes

Disadvantages

- No liability shield unless it becomes a limited liability partnership
- Transfer to the next generation is not as easy as with some other entities

According to the USDA agricultural census, in 2002, 7 percent of Vermont farms were organized as farm partnerships. Vermont's partnership statute was updated and overhauled in 1997, and became effective as of January 1, 1999. The general concepts under the new and old statutes are quite similar. The primary difference is that the new law offers a limited liability partnership option.

Simply put, a partnership is any association of two or more persons formed with the purpose of carrying on a business for profit as co-owners.⁷ The "persons" or partners can be other partnerships, LLCs, business trusts, corporations, or any other legal or commercial entity.⁸

While it isn't legally necessary, it's best to have a written partnership agreement that governs the relations between the partners.

An Implied Partnership

It is possible to form a partnership without any written or formal declaration. Intent to form a partnership isn't necessary. A partnership can be "implied" simply by the fact that you conduct business with another person or entity and share profits.⁹ However, joint ownership and/or sharing gross returns aren't enough to establish that a partnership exists—sharing profits suggests that there is a partnership.¹⁰ One of the dangers of being in an unintended partnership

is that partners are liable, both individually and together, for the debts of the partnership.

Understanding the partnership structure is all about understanding the law of "agency." Each partner in the partnership is an agent of the partnership, and the partners are agents of one another. Each partner can contractually bind the partnership and the other partners in the ordinary, everyday matters of the partnership.¹¹ Unless a partnership agreement provides otherwise,

What's in a Partnership Agreement?

A typical partnership agreement includes the following:

- Purpose of the partnership,
- Capital contributions of each partner,
- Allocation of profits and losses,
- Management responsibilities and duties of each partner,
- Agreement to buy and sell in the event of death or disability of a partner with mechanism for annual valuation of the business,
- Provisions for terminating or winding up the partnership.



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matters outside the ordinary course of business must be authorized by all the partners. You can limit the scope of a partner's authority to act for the partnership by the terms of the partnership agreement. The limitation upon an individual partner's authority, however, must be on file in a "statement of partnership authority" with the Secretary of State's office.¹² With the exception of real estate transfers, those doing business with the partnership will also need to be aware of this limitation or it will not be effective.

Special Duties

Partners owe certain duties to the partnership and to each other. These duties include a duty of loyalty and a duty of care. Partners must refrain from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law, and they must discharge their duties with an obligation of good faith and fair dealing.¹³ They must also account to the partnership for any property profit or benefit derived from the conduct of the business or from a use of partnership property. This includes the appropriation of a partnership opportunity.

Liability or Limited Liability

In a general partnership, all partners are jointly and severally liable for all obligations either in tort or in contract of the partnership.¹⁴ Individual partners may thus be held liable for the tortious conduct of

another partner while acting for the partnership. Under Vermont's new partnership statute, which became effective on January 1, 1999, a new option was offered to allow general partnerships to convert, or new partnerships to be formed, as limited liability partnerships. The advantage to this is that any obligation arising in contract, tort, or otherwise is solely the obligation of the limited liability partnership, not the individual partners.¹⁵ The liability shield for a limited liability partnership is virtually identical to the liability shield provided to Vermont corporations and LLCs.

To become a limited liability partnership, the partners must file a "statement of qualification" with the Vermont Secretary of State's office and pay a filing fee of \$75.00. The statement of qualification is a simple form that requests some basic information about the business and its principals. Limited liability partnerships must also file an annual report with the state to maintain the liability shield. The partnership must put others on notice that it is operating as a limited liability entity by including "LLP" or some other indicator in the business name, letter head, checks, and other business documents.¹⁶ The partnership agreement should be restated to reflect the election to become a limited liability partnership.

Taxation for Partnerships and Limited Liability Companies

A farm partnership or an LLC that chooses to be taxed as a partnership is a "pass-through entity," which means that each partner or LLC Member

What is Basis?

Under the simplest definition, the "tax basis" in property is its purchase price. If the price of the asset was \$75,000.00, its tax basis is \$75,000.00. The tax basis can be adjusted over time to reflect improvements made to the property – addition to basis – or depreciation taken on the property – reduction in basis. If the property is sold for more than its tax basis, a tax will be due on the gain. The tax rate will depend upon how long the property was held. For most types of property held for more than 2 years, the federal capital gain rate is 15 percent.

Gain or loss must be reported whenever property is sold or exchanged or upon any transaction deemed by the IRS to be a taxable transfer. Even a foreclosure of property is viewed by the IRS as a taxable transfer. And most importantly for our purposes, when property is transferred into a new entity, it will sometimes result in the recognition of gain.

must report any share of partnership income, gain, loss, or deductions on his or her individual tax return. Each partner's "distributive share" must be spelled out in the partnership or operating agreement. The partners or members may agree to split profits any way they choose. This distributive share will be taxed to the individual partner or member whether the distribution is



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made or not. There are some limitations, however, on the amount of loss that individual partners or members may claim in any one year.¹⁷

Each partner or LLC member will have a basis in the business that must be tracked over the life of the partnership or LLC. A partner's basis in the partnership will determine whether he or she owes any capital gain tax when the partnership is dissolved. It will also be used to determine whether there are any limitations on deductions a partner can claim from the partnership. Generally, the basis in the partnership equals any cash a partner contributes plus the basis of any contributed property. The basis will change over time depending on depreciation taken or new investment in the business.

The following is an example of calculating basis:

Dick and George decide to form a partnership to harvest wood and manufacture wood products. George contributes \$50,000 in cash and debt-free forest land for which he paid \$250,000. Dick contributes \$250,000 in cash and wood-processing equipment for which he paid \$50,000. Given these figures, both George and Dick have a basis of \$300,000.

A transfer of property into a partnership in exchange for a partnership interest will generally not trigger recognition of gain. There are, however, some exceptions to this rule, most notably the "debt in excess of basis" rule.

Debt in Excess of Basis

You need to be careful when transferring property subject to debt into a partnership or an LLC that is taxed like a partnership. If the debt is assumed by the partnership or LLC and the partner or member is relieved of personal liability for the debt, the individual partner may have to report a gain on the transfer. The transfer of responsibility for the debt is considered by the IRS as the same thing as a cash distribution from the partnership. If the amount of the debt is in excess of the partner's basis in the partnership, the partner will have to recognize the difference as gain. This situation frequently arises in situations where a partner is contributing farm-raised or other farm assets with a zero basis.

The following is an example of such a case:

Dick and George decide to form an LLC to produce yogurt. George contributes \$50,000 in cash and a herd of Jersey cows worth \$100,000. The cows have a zero basis and they are subject to a \$100,000 operating note for which George is personally responsible. The partnership assumes full responsibility for the note and George is relieved of any personal liability. Dick contributes \$100,000 in cash and yogurt processing equipment for which he paid \$50,000. At this point, George's basis is \$50,000, and Dick's basis is \$150,000.

Because the partnership relieved George of a \$100,000 liability, he is deemed to have received a \$100,000 cash distribution from the partnership.

The cash distribution exceeds George's basis in the partnership. He will have to recognize gain on the transfer to the extent that the debt exceeds his basis. In this case, he will have to report a gain of \$50,000 upon formation of the partnership.

However, if George remained personally liable for the note, there would be no distribution and no gain on transfer of the cows. He must remain personally liable – offering a secondary guarantee of the indebtedness to the creditor would not be adequate to avoid recognizing gain.

George

Contributions of:

\$50,000 cash

\$100,000 cows subject to debt of \$100,000 assumed by LLC

George's basis is \$50,000

George was relieved of a \$100,000 debt. The debt exceeds his basis by \$50,000 which is his gain on the transfer.

Dick

Contributions of:

\$100,000 cash

\$50,000 equipment

Dick's basis is \$150,000

Ease of Transfer

Partnerships fall between sole proprietorships and LLCs when it comes to the ease of transferring the operation to the next generation. In an LLC, you can transfer "units" representing a fractional share of the farm assets in the entity. In a partnership,



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ownership is tracked in each individual partner's "capital account." The partner's capital account will change from year to year, depending on the value of the business and the partner's contributions or withdrawals of capital. A common strategy for

farm transfer in a partnership setting is to allocate the income share of the partnership on a different basis than the capital shares. A senior generation partner can transfer just an income share to a junior partner. For example, the junior partner joins

the partnership with a zero capital interest and a 20 percent income share. Income not withdrawn by the junior partner at the end of the year can be allocated to his capital account and thereby gradually increase his or her share of the business.

Federal Farm Programs and Entity Choice

Participants in federal farm programs must be actively engaged in agriculture. Payments per "person" are also limited. The payment limitations vary by program. If the operation is conducted jointly with others (a parent or child or spouse, for example), the entity chosen will affect whether the operation is considered one "person" or several. As a general rule, each partner in a general farm partnership is considered a "person." Three partners farming under a general partnership

could effectively triple the payment limitation. On the other hand, entities that enjoy limited liability, such as a limited liability company, a corporation, and even a limited liability partnership, are considered just one "person" for purposes of the payment limitation.

Spouses who farm together in a general partnership are treated differently. Spouses who farmed separately prior to their marriage and who continue to farm separately after the marriage may be considered two

"persons." In addition, spouses who are actively engaged in farming and are not receiving a payment through another farming entity may each be considered a "person." Being actively engaged requires each spouse to put "at risk" a significant contribution of capital commensurate with their share of profits and losses and active personal labor.

Any change in a farming operation that increases the number of "persons" entitled to a payment will be carefully

evaluated by the Farm Services Agency (FSA) to ensure it is bona fide and substantive and not primarily for the purpose of increasing farm program payments. FSA should be notified whenever:

- A new partner or member joins the farming operation.
- There is a significant gift or sale of farm assets to a new participant in the farm business.
- There is any change that might affect the "person" determination.



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Limited Liability Companies

Advantages and Disadvantages of Limited Liability Companies

Advantages

- Ease of transfer
- Flexibility in structuring management, income and control
- Limited liability
- Flexible taxation
- Limited liability for a one-member entity
- Ease of transfer

Disadvantages

- Cost of formation can be substantial
- Time spent observing the formalities such as record keeping and learning about the entity can be substantial

According to the most recent agricultural census, there are very few farm LLCs in Vermont. LLCs, along with non-profits and cooperatives, accounted for little more than one percent of all farm business entities in Vermont in 2002. LLCs, however, may be the fastest growing choice of entity in the state. According to the Vermont Secretary of State's office, there were 7,258 LLCs in Vermont as of January 1, 2004. LLCs have only been authorized by Vermont law since 1996. Unfortunately, it is not clear how many of these entities are farm businesses.

Formation and Management

An LLC can be formed by filing Articles of Organization with the Vermont Secretary of State's office. The filing fee is \$75.00. The Articles of Organization must include the name and address of the company, names and addresses of the organizers, and basic information about the business. The Secretary of State will return a Certificate of Organization to the organizers. LLCs must also file an annual report for which the filing fee is \$15.00. Failure to file the annual report can result in "termination," jeopardizing among other things the limited liability shield. Reinstatement for a fee is available.

LLCs are governed by "operating agreements" that you are not required to file with the Vermont Secretary of State's office. Consequently, many of the details of the capitalization and management of the business

remain private. Owners of the LLC are called "members" and they own "units." Unlike a partnership, it is possible to have a one-member LLC.

Topics Included in Typical LLC Operating Agreements:

- Definition of terms found in the agreement;
- Formation of the company (name, principal place of business, duration, and purposes of the company);
- Books, records, and accounting aspects of the company;
- Capital contributions of members;
- Allocations of income and loss and distributions to members;
- Meetings of members;
- Management of the company;
- Tax matters;
- Transfers of ownership interests including buy-sell agreements;
- Dissociation of members;
- Purchase of dissociated members; and
- Dissolution of the company.



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Some aspects of the operating agreement are dictated by statute and cannot be varied. As in a partnership, members owe a duty of good faith and fair dealing to one another, and this duty may not be waived or altered by the operating agreement. Otherwise, there is tremendous flexibility in structuring ownership, management, control, and rights of transfer of individual LLC members.

An operating agreement, for example, can restrict a member's rights to transfer units outside the family. The operating agreement can limit the management rights of parties who receive units as a result of bankruptcy or divorce. Voting rights may also be restricted by issuing voting and non-voting units. In this way, control of the business can be initially concentrated in the senior generation and gradually transferred to the next generation. It is this flexibility that has led to the popularity of LLCs and the reason that they are particularly useful in estate planning.

In Vermont, an LLC may be either manager-managed or member-managed. Choosing to be a manager-managed entity allows members to avoid the agency pitfalls of the general partnership. If the LLC is manager-managed, only the manager can bind the company in matters related to carrying on in the ordinary course of business. If the LLC is member-managed, then each member can be an agent of the business and can bind the LLC in these matters. Members may also designate certain members to act in certain areas. One member, for example, may be designated to deal with all matters of taxation.

The operating agreement of the LLC should address the potential for sale or transfer of units to new members or to buy out existing members. Where there is a buy-sell agreement, there should also be a method of valuation. Members may decide to do annual appraisals or to agree among themselves on the value of all LLC property every year. (See “The Buy-Sell Agreement” on page 38.)

As in a partnership, profits and losses needn't be strictly based on ownership share. Allocations, for example, can reflect a greater contribution of management and labor on the part of one or several members. The operating agreement may also allow members to increase their ownership shares by reinvesting their share of profits back into the business.

Limited Liability

As the name suggests, LLC members enjoy limited liability, meaning that they are not personally liable for the debts, obligations, or other liabilities of the company.²³ As is the case in other limited liability entities, however, an individual member may become personally liable for his or her own acts or conduct while acting on behalf of the business. (See “The Limits to Limited Liability” on page 4.)

As is the case with other limited liability entities, a court may decide to “pierce the veil” and look to the personal assets of the members to cover the obligations of the business where members disregard the entity or the entity is undercapitalized.

(See “Losing the Liability Shield” on page 4.)

Taxation of LLCs

LLCs can choose to be taxed as a corporation — a double taxation entity — or as a partnership — a pass-through entity. Single-member LLCs are “disregarded” entities, meaning that the IRS disregards the entity entirely and the member reports income and losses on his or her personal tax return.

Most farm LLCs choose to be taxed as a partnership. In instances where an entity is considering a broader array of employee benefits, choosing corporate taxation may make more sense. Most farm operations will choose pass-through taxation. For LLCs taxed as partnerships, the operating agreement can provide some flexibility in terms of allocating income, losses, deductions, and credits among LLC members. This flexibility can be useful when a senior generation member is in a higher tax bracket and can make better use of deductions or losses. The allocations can vary somewhat from the member's actual capital contributions, but the IRS wants to see a relationship between the allocation of losses and deductions and the member's actual economic benefits and burdens. Deductions on partnership losses may also be limited by rules regarding passive loss and in cases where the losses exceed a member's basis in the LLC.²⁴

With some exceptions, when a member contributes land or other farm assets to an LLC taxed



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as a partnership, there will be no tax consequence. One exception to this rule is described in “Debt in Excess of Basis,” page 9, in the previous section on partnership taxation. This is the case where a member contributes property subject to a debt, the LLC assumes the debt, and the member is relieved of personal liability for it.

A partner or a member may also have to recognize ordinary income if he or she exchanges ser-

vices for an interest in the business.

As is the case in partnerships, LLC members will have a basis in the business that must be tracked. See “Partnership Taxation for Partnerships and Limited Liability Companies,” page 8.

Ease of Transfer

The LLC probably offers the easiest means of

transferring farm assets from one generation to the next. Farmland, livestock, equipment, and other farm assets can be reduced to “units” that can be transferred annually from the senior generation to the junior generation. For example:

The Jones family wants to begin transferring the farmland to their farming heirs. They create the Jones Family Farmland LLC. The LLC issues

Re-Titling Assets to a New Entity

A transfer of real estate from individual ownership to a business entity will have potential tax and other consequences.

The Vermont Homestead Exemption

Certain unencumbered property is exempt from the reach of creditors in Vermont. A Homestead Exemption consisting of a dwelling house, outbuildings, and the land used in connection therewith but that does not exceed a value of \$75,000, is exempt from attachment by creditors. Two cases in Vermont Bankruptcy Court have held that land transferred to a partnership or a limited partnership loses its status as homestead property, and therefore

the exemption is not available. It’s likely that Vermont courts would reach a similar conclusion for homestead property transferred to any other separate entity such as a corporation or an LLC.²⁶

Current Use

Putting farmland into a business entity won’t jeopardize eligibility for Vermont’s current use program because a “person” under the current use statute includes any individual, firm, corporation, partnership, or other form of organization or group of individuals.²⁷ A new application will need to be filed, however, to reflect the new ownership status within 30 days of forming the entity.

Property Transfer Tax

Vermont imposes a transfer tax on some transfers of real estate. In the case of working farmland, the property transfer tax is currently five-tenths of one percent of the entire value of the property transferred if the property remains in agricultural production for six years after the transfer or three years if the property is in current use.²⁸ Transfers of land to a corporation, LLC, or a partnership at the time of its formation AND where no gain needs to be recognized under federal IRS rules are also exempt from the land transfer tax.²⁹ For a discussion of the federal gain on transfer rules, see “Partnership Taxation” on page 8.

Land Gains Tax

Vermont also imposes a tax on gain from the sale or exchange of real estate other than a principal residence. The tax rate in Vermont is a function of how many years the land was held. The rates are designed to capture the lion’s share of any profits from a short-term investment in land. However, if the federal Internal Revenue Service doesn’t tax the gain on the transfer, neither will the state of Vermont.³⁰ See “Partnership Taxation” and “What is Basis?” on page 8, for a general discussion of the federal rules on taxing gain.



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20 Tier A units and 480 Tier B units. The Tier A units have both economic and voting rights, meaning that holders of Tier A units share in the Company's profits and losses and can vote on issues of management. The Tier B units, however, have only economic rights, meaning that holders of Tier B units share in profits and losses but they have no voting rights and therefore have limited management rights.

The operating agreement also restricts transfers of the units, requiring agreement by the other members for transfers outside the family. The LLC operating agreement also limits the rights of transferees who come to own the units as a result of divorce or bankruptcy. Initially, Mr. and Mrs. Jones each hold 10 of the Tier A voting units. As well, Mr. and Mrs. Jones each own 240 of the Tier B units. Each year, they will transfer some Tier B units to their heirs. The value of their gifts will stay within the annual exclusion under the gift tax.

While the Jones' initially transfer only the Tier

B units, within five years they will have begun to transfer the voting shares to the farming heirs. As management and ownership shifts to

the heirs, they may continue to receive distributions of income tied to the Tier B units they have retained.

If you're looking for:	Consider these entities:
Limited Liability	Limited Liability Partnerships, Limited Liability Corporations, Corporations, Cooperatives, and Non-profits all enjoy limited liability. Limited partners in a limited partnership also enjoy limited liability.
Partnership (pass-through) Taxation	Partnerships, Limited Liability Partnerships, and S Corporations are all taxed like partnerships. Limited Liability Companies may choose to be taxed like a partnership.
Corporate Taxation	C Corps are taxed as corporations. Limited Liability Companies may also choose to be taxed like a corporation.
Ease of Transfer	Business entities that make it easier to track and transfer individual ownership interests make farm transfer from one generation to the next much easier. These include Corporations, Limited Liability Partnerships, Partnerships, and Limited Liability Companies.
Ability to Raise Outside Capital	Limited Partnerships, Limited Liability Companies, and Corporations can all facilitate outside investments. Farm Cooperatives can raise capital from co-op members.



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The Farm Corporation

Advantages and Disadvantages of Farm Corporations

Advantages

- More attractive to outside investors
- Ease of transfer of shares
- Flexible taxation
- Limited liability shield

Disadvantages

- Legal and other costs of formation
- Ongoing formalities, including annual meetings and minutes, unless it is a “close” corporation
- Tax consequences of dissolution
- Potential for double taxation of profits

According to the Agricultural Census, there were 261 family-held farm corporations in Vermont in 2002. A corporation is a separate legal entity. The life of the corporation begins when the Secretary of State issues a “Certificate of Incorporation.”³¹

A corporation is owned by its “shareholders.” The operation of the corporation is governed by by-laws and a Board of Directors with officers elected by the shareholders. In Vermont, corporations must have, at a minimum, a president and a secretary. It may have other officers if the by-laws so require.

As a separate legal entity, the business principals owe certain duties to it. Directors, for example, must act in good faith, with reasonable care, and in the best interests of the corporation,³² rather than in their own self-interest.

Corporations are limited liability entities, meaning that shareholders will not be held personally liable for the acts or debts of the corporation. As noted earlier, however, a shareholder may become personally liable by reason of his or her own acts.³³ For example, a shareholder who participates in a fraudulent business practice involving the corporation can be held personally liable for his or her own actions.

Distributions to Shareholders

Along with limited liability come certain requirements with respect to capitalization. To maintain the limited liability shield, a corporation must

have enough capital to meet its ordinary business obligations. Distributions to shareholders that render the corporation unable to pay its debts as they become due in the usual course of business or that

Corporate Formation

The filing fee for the Articles of Incorporation is \$75.00. Corporations must also file an annual report and include a filing fee of \$25.00.

The Articles of Incorporation *must* include:

- Corporate name,
- Classes of shares and number of each class that the corporation is authorized to issue,
- The street address of the registered office and initial registered agent,
- The name and address of each initial incorporator, and
- Classes of shares with rights to vote and rights upon dissolution.

The Articles of Incorporation *may* include:

- A listing of the Board of Directors,
- The purpose of the business and other information that would be included in the corporate by-laws.



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lead to insolvency are prohibited by law.³⁴

Corporate Taxation Issues

Corporations may choose to be taxed as a pass-through entity, as an “S” Corporation, or as a double taxation entity as a “C” Corporation. The “C” and “S” come from the chapter headings of the legislation authorizing this tax treatment.

As a “C” Corporation, the corporation is taxed as a separate entity. Corporate income is taxed first

at the corporate level and again at the shareholder level when income is distributed as dividends.

As an “S” Corporation, the corporate income is not taxed at the corporate level but “passes through” and is taxed at the shareholder level. An “S” corporation provides a limited liability shield but treats taxes more like a partnership.

A Close Corporation

In Vermont, corporations with fewer than 35 share-

holders can elect to form or convert to a “close” corporation.³⁵ Close corporations can be operated directly by the shareholders. This eliminates the need for a board of directors, who are the same people as the shareholders in many small corporations. A close corporation can dispense with by-laws and operate under “shareholder agreements” that are similar to partnership agreements.

A close corporation can also eliminate the requirement for annual meetings and may choose to be taxed as either a “C” or an “S” corporation.

Non-Profit Corporations

Farms provide many “public goods.”³⁶ Open space, wildlife habitat, and recreational opportunities are just some of the benefits that farms provide to the community. Many farmers are also highly skilled in traditional and non-traditional farm or homesteading practices or crafts and can offer educational opportunities to the community. But simply because a farm offers goods and services that have educational or environmental benefits does not mean that the non-profit business structure is a good choice for the business. If these goods and services are incidental to the farming operation and are offered to the public for a fee – for example, an agri-tourism business that invites city dwellers to spend a week on the farm learning how to milk cows – a for-profit entity is probably the best choice.

The non-profit structure provides federal and state income and other tax exemptions and broader access to grants from foundations as well as contributions from private individuals. Along

with this access to funds, however, comes a great deal of complexity. The complexity is a result of the IRS rules intended to minimize fraud or schemes to avoid taxation. The non-profit form

Advantages and Disadvantages of Non-Profit Corporations

Advantages

- Significant tax exemptions
- Availability of grants
- Opportunity to contribute to the public good

Disadvantages

- Substantial complexity
- Requires non-profit administration skills
- Assets belong to the public and must be transferred to another non-profit at termination
- May not seek private investment capital
- Special duties owed to the public
- Penalties for violating rules against private benefit from use of non-profit assets



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requires a farm operator to have a high tolerance for complexity and a healthy respect for the need to comply with IRS rules. It requires someone who can consistently and carefully separate the non-profit finances from the for-profit aspects of the farm. The complexity also means that there are certain economies of scale to be considered. Unless the potential for grant income is significant, it may be best to consider alternatives to the non-profit structure. (See “Alternatives to Forming a Non-Profit” on page 18.)

Non-profits are governed by both state and federal law. Vermont law governs the formation and operation of non-profits. Both Vermont and federal law govern taxation issues relevant to non-profits. On the federal level, non-profits that the IRS designates as “501(c)(3)” organizations receive federal income and other tax exemptions and benefits. While there are other types of non-profits under federal law, we will only deal with 501(c)(3) corporations, which are the most common in Vermont.

You can form a non-profit under Vermont law without bothering to seek a 501(c)(3) designation from the IRS, but you will forgo significant federal tax benefits as a result of doing so.

Generally, to acquire and maintain 501(c)(3) status, the following criteria must be present:

1. The corporation must be organized for a religious, charitable, or scientific purpose and the organization’s activities must further that purpose.

2. No private benefit must accrue to members from organizational activities, assets or earnings. Use of the organization’s assets for private gain or excess compensation will cost an organization its status as a 501(c)(3). When a 501(c)(3) organization is dissolved, its assets must go to another 501(c)(3).

3. The organization must not violate IRS rules about lobbying and electioneering. While a broad range of public educational activities are allowed, the IRS frowns on direct lobbying about legislation in excess of certain limits or on supporting a particular electoral candidate.

4. The organization must also demonstrate to the IRS that it has sufficient public support to qualify as a public charity. Charities that can ascertain that at least one-third of their total support comes from governmental agencies and private individuals pass the test. Charities that fail the mechanical test may still qualify if certain facts and circumstances indicate an effort to attract new and additional public support.

For a more detailed description of qualifying as a 501(c)(3) organization, see “IRS Publication 557: Tax Exempt Status for your Organization” at <http://www.irs.gov/pub/irs-pdf/p557.pdf>.

The Board of Directors

Under Vermont law, a non-profit must have a least three board members. Directors must be

individuals and cannot be other profit or non-profit corporations or an LLC, for example.³⁷ A majority of board members must be “financially disinterested.” No more than 49% of the board can be employees, independent contractors, consultants, or otherwise receive compensation from the corporation or a spouse, sibling, parent, or child of same.³⁸ Board members have special duties of good faith, ordinary care, and must act in the best interests of the corporation.

State and Federal Taxation

Non-profit corporations that have received a 501(c)(3) designation from the Internal Revenue Service are exempt from federal income tax. Vermont law also exempts 501(c)(3) organizations from state corporate income taxes.³⁹

Exemptions are also available to Vermont non-profit 501(c)(3) corporations for the meals and room taxes,⁴⁰ sales and use taxes,⁴¹ land gains taxes,⁴² and local property taxes.⁴³ The local property tax exemption is available even if an organization has not been given a 501(c)(3) designation provided that the property is used for “public, pious or charitable uses.”⁴⁴

In addition to the direct tax exemptions available to non-profit corporations, donors to non-profits designated as 501(c)(3) status may take a charitable deduction for their contributions to the organization. Private foundations often require proof of 501(c)(3) status prior to making a grant.



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Non-profits, however, are NOT exempt from employment taxes, and they also have to be concerned about something called “unrelated business income” which will be taxed by the IRS at the regular corporate rates.

Unrelated Business Income Tax

Tax exempt organizations must also be aware that income derived from the organization’s business activities may be subject to the “unrelated business income” tax.⁴⁵ Business income from a trade or business that is regularly carried on and related to the organization’s exempt purposes may be subject to taxation at the regular corporate tax rates. This issue is arising more often as non-profits become more entrepreneurial in their activities and their fundraising and the IRS becomes more savvy at analyzing these transactions. Many of the cases, for example, involve non-profit organizations renting or selling their mailing lists and using the earnings to fund their charitable work. State and local tax issues also arise in these cases. Unrelated Business Income Tax (UBIT) is one more indication that if the farm activity is primarily fee-based, a for-profit entity makes the most sense.

Raising Capital

Non-profits are prohibited from issuing capital stock, so they can’t raise investment capital from their members. They may, however, impose dues and/or fees upon members to raise operating funds.⁴⁶ They may also establish different classes of members⁴⁷ or decide not to be a membership organization at all.

Limited Liability and Non-Profit Corporations

Vermont law provides that members of a non-profit are not personally liable for the acts, debts, liabilities, or obligations of the corporations.⁴⁸ Vermont law also provides limited liability to directors, officers, and trustees of 501(c)(3) organizations who serve without compensation. As long as they act in good faith, they will not be personally liable for any acts or omissions committed while acting in the scope of their official duties. They are also shielded from liability for any acts or omissions of employees of the non-profit or other directors or officers.

Farm Transfer

Non-profit assets belong to the public. When a non-profit terminates, the assets must go to an

other non-profit. As such, the non-profit structure is not appropriate where generational transfer is a goal. As well, given the strictures on private benefit and unrelated business income, the non-profit structure is not appropriate where a primary objective is to build wealth and provide for one’s retirement.

Alternatives to Forming a Non-Profit

Incorporating charitable or educational purposes into a farming enterprise is an income diversification strategy. Forming and managing a non-profit and maintaining 501(c)(3) status, however, can be daunting. Farms seeking grant income have some alternatives to forming a non-profit entity. Farms can partner with existing non-profits with purposes and a mission that are complementary to what the farm has to offer. The non-profit can contract with the farmer to provide these services for a fee. The non-profit can cover that fee with grant income. The local historical society, for example, can pay the farmer to host a workshop on farming with horses. Farmers, however, shouldn’t expect to make a lot of money on these charitable endeavors. It is, after all, charity.



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Agricultural Cooperatives

Advantages and Disadvantages of Agricultural Cooperatives

Advantages

- Anti-trust exemption
- Significant tax advantages
- Capture economies of scale
- Add bargaining power
- Democratically controlled
- Operated for mutual benefit
- Limited liability for members

Disadvantages

- Relative difficulty of raising capital
- Tax complexity
- Substantial commitment of time to manage the cooperative

There is a rich tradition of cooperative organization in agriculture. The Grange in the late 19th century was one of the earliest proponents of the cooperative structure in agriculture as a way to increase the bargaining power of individual farmers and capture economies of scale. Examples of farm cooperatives are legion. The federal Farm Credit System established in 1916 is a cooperative that provides credit to farmers and other cooperatives. In its zenith, the cooperative model was instrumental in bringing electricity to rural America after the Capper-Volstead Act provided anti-trust immunity.

Co-ops have been used to provide marketing, farm supply, and farm services to members. What's so different about a cooperative? The biggest difference between a cooperative and other business entities is that ownership and control of the business is in the hands of the users or producers of the goods and/or services provided by the co-op, i.e., the members of the cooperative. Cooperatives are democratically controlled. Unlike a corporation, for example, voting power is not a function of how much stock a member owns. In a cooperative, each member gets one vote.

The traditional principals of cooperatives include:

- Open membership – anyone can be a member.
- One member, one vote.

- Cash trading – no credit to members.
- Membership education.
- Political and religious neutrality.
- No unusual assumption of risk.
- Dispersed ownership – limits on number of shares of co-op stock that any one member can own.
- Goods sold at regular retail prices.
- Profit (margins) distributed according to patronage rather than ownership – corporations pay dividends on number of shares; co-ops pay patronage dividends based on usage of goods or services.
- Operating capital comes from members — retained patronage dividends, which are a portion of individual members' savings or earnings that the cooperative retains as investment capital.

Special Benefits to Cooperatives – Antitrust Exemption

Agricultural cooperatives that meet certain tests under federal and Vermont law are entitled to exemption from federal and state anti-trust laws. Formation and governance of the cooperative is governed by Vermont law, but both Vermont and federal law govern the availability of the anti-trust exemption. The federal law is called “Capper-Volstead” and it gives farm cooperatives a limited exemption from anti-trust for the marketing of farm products co-



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operatively. Farmers may “collude,” meaning they can agree on a price to be charged for the goods and services produced by members. They may also share pricing information with one another. This provides a significant marketing advantage. For other kinds of entities, price collusion and sharing price information is illegal.

The agricultural anti-trust exemption is only available to cooperatives that meet certain organizational and operational tests as set out in Capper-Volstead:

1. Co-op members must be farmers or persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut, or fruit growers who collectively process or/and market their goods.
2. The cooperative must be operated for the mutual benefit of its members.
3. The cooperative must adhere to the principle of “one member, one vote.”
4. The dividends paid to members on stock or membership capital must be limited to 8 percent per annum.
5. The cooperative may not deal in the products of non-members to an amount greater in value than that it handles for members⁴⁹ and no greater than 49 percent of product by value can come from

non-members.

There is also a state exemption from anti-trust law in Vermont and another set of organizational and operational tests. A cooperative will not be deemed to be a “conspiracy or a combination in restraint of trade” under Vermont law or an illegal monopoly or an attempt to lessen competition or to fix prices arbitrarily, provided it complies with statutory requirements.⁵⁰ These requirements mirror the federal requirements but there are a few differences.

In Vermont, if you call yourself a cooperative, you must meet the following minimum requirements:

- One member, one vote.
- Interest or dividends on paid-up capital stock that is paid to members shall not exceed 6 percent.
- The cooperative must maintain a reserve fund equal to 10 percent of net annually until it has a reserve of 50 percent of the paid-up capital stock.
- The remainder of earnings must be distributed based on patronage.
- No more than 10 percent of the capital stock can be owned by any one member.
- Members must be producers of the products the co-op handles.
- Certificates of stock in the co-op must include a statement that says the holder is entitled to only one vote.⁵¹

Members of an agricultural marketing coopera-

tive can be individuals, firms, partnerships, corporations, or associations, provided that the member is engaged in producing the agricultural products handled by the co-op.⁵² Co-ops can, in turn, organize, own, or be a shareholder in other corporations.⁵³ For example, a cooperative may take an ownership interest or may itself form, operate, and control a corporation engaged in value-added activities – preserving, drying, processing, canning, packing, storing, handling, shipping, utilizing, manufacturing, marketing, or selling the agricultural products handled by the cooperative.

Value-Added Cooperatives in Vermont

Vermont law gives marketing cooperatives broad authority to add value to whatever their members produce. Cooperatives may “engage in any activity in connection with the purchasing, marketing, selling, preserving, harvesting, drying, processing, manufacturing, canning, packing, grading, storing, handling, or utilization of any agriculture products, or manufacture or marketing of the by-products thereof.”⁵⁴ However, the majority of the product, by value, that the cooperative handles must come from its members.

Limited Liability

Co-op members can not be held personally liable for the debts of the cooperative.⁵⁵ However, in a post-Enron nod to executive accountability, Ver-



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mont law provides that any officer or director of a cooperative who knowingly subscribes to a false statement relative to the issuance of capital stock or false financial statement faces fines and imprisonment and shall be individually —personally — liable to shareholders.⁵⁶

Tax Benefits to the Cooperative Model

Corporate shareholders receive a return on their investment in the form of appreciation in the value of their stock as well as dividends paid from corporate profits. Corporate dividends are paid based on the number of corporate shares owned. In a cooperative, member benefits are based on patronage of the co-op. A cooperative distributes net earning as a “patronage dividend” or a “patronage refund” to members based on how much business the member did with the co-op. In some cases, the cooperative retains a portion of the patronage refund to use as operating capital for the cooperative – the retained patronage dividend. In this way, members finance the growth of the co-op. Members also provide capital by purchasing their membership shares.

Cooperative Tax Advantages

Cooperatives enjoy significant tax advantages over other entities. If all the IRS rules are followed, a cooperative can deduct both the patronage dividend paid to the farmer AND the retained patronage dividend used for operating capital. This allows the cooperative

to significantly reduce its taxable income and its tax liability. Tax rules for cooperatives are complex and require specialized tax advice from a professional familiar with the cooperative structure.

Special Duties of Cooperative Members

Cooperative members are expected to actively contribute to the management and financing of the co-op.

Among the duties of cooperative members are the following:

- Knowingly exercise their vote to elect or remove directors; adopt and/or amend Articles of Incorporation and Bylaws; and vote on dissolution, merger, or consolidation.
- Provide capital in the form of retained earnings or up-front investment.
- Patronize the co-op.

New Generation Cooperatives

Most of the current growth in new cooperative formation is in the so-called “new generation cooperatives” (NGC). **These entities are characterized by the following:**

1. New generation cooperatives add value to raw

farm commodities. These cooperatives add value by processing commodities to capture a larger share of the consumer food dollar for their members. They seek to utilize the economies of scale necessary to be competitive in the processing/retail market.

2. Membership is not open. The number of members in the co-op is limited. The number of members is dictated by the capital needs of the entity. Members are expected to provide the capital “up front” for the construction of processing facilities, feasibility studies, and other needs of the cooperative.

3. Transferable delivery rights. Members provide capital by purchasing “delivery rights” and only so many “delivery rights” are sold. The price of the delivery rights is a function of the cooperative’s capital needs for facilities and so on. Delivery rights are transferable to other eligible producers although the cooperative board of directors will ordinarily approve such transfers and may even set the price. The value of the delivery rights will appreciate or depreciate depending on the success of the cooperative or the income potential from the enterprise.

4. Membership versus Delivery Rights. Typically, these cooperatives issue two classes of stock. Each member gets one Class A share, which is a membership share. Class B shares are sold to members and include delivery rights. Delivery rights vary depending on the number of Class B shares the member



LEGAL STRUCTURE OF THE FARM BUSINESS

purchases. The delivery rights specify the amount of product, the delivery date, and how much and when the farmer will be paid. If the farmer defaults, the delivery agreement usually allows the co-op to purchase commodities on the open market and seek reimbursement from the farmer.

5. Capital and Patronage Dividends. These cooperatives typically pay out most or all of their net income to their members based on how much product they delivered. Because the farmers provide capital up front by purchasing delivery rights, there is less need to retain earnings to generate capital.

NGCs in Vermont

As long as the NGC complies with the minimum requirements for a cooperative under Vermont law

and under Capper-Volstead, it is acting within the law. But the primary difficulty facing NGCs in Vermont isn't legal, it's financial. Few Vermont farmers are in a position to come up with the considerable amount of up-front capital necessary to start an NGC.

Some states, Minnesota and Wyoming, for example, have amended their cooperative statutes to allow "outside" member investors who do not patronize the cooperative to own it and receive profits. In Minnesota, for example, these outside investors may own up to 99.99 percent of the equity of the cooperative and receive up to 85 percent of its profits. This type of equity structure may put the federal and state level anti-trust exemption at risk because members may not be producers or the cooperative may no longer be operated for the mutual benefit

of its members but for that of the outside investors.

Along with the anti-trust exemption, this type of equity structure might also subject a Vermont NGC to the securities regulations governing other kinds of businesses that seek investors. In Vermont, securities that are offered or sold only to cooperative members as a requirement of membership or are issued as a patronage dividend are exempt from the requirement of securities and broker registration requirements.⁵⁷

If outside investors are necessary to the farm business, incorporation or an LLC may be a better option. An LLC can be structured to "behave" like a cooperative. States could also offer low-interest community development loans, tax incentives, and grants to support NGCs and ease the need for outside investors.

Legal and Other Professional Services for Business Formation

In 2005, the average hourly attorney fee in Vermont was \$125.00 an hour. A typical simple entity formation can cost anywhere from \$500.00 to several thousand dollars. If the formation requires special drafting or raises novel tax or other issues, the fee can be quite high. Farmers who come to

the law office well informed and well prepared can save a lot of money. Carefully completing the attorney's informational forms can save the attorney time and save the farmer a lot of money.

Land Link Vermont has an informational list of professional attorneys and accountants who han-

dle farm transfer, business formation, and other legal, tax, and accounting matters. This list can be a good place to start. Go to:

<http://www.uvm.edu/landlinkvt/referralnetwork.html>.



LEGAL STRUCTURE OF THE FARM BUSINESS

Case Study: Group Ownership at Arethusa Collective Farm

By Don Jamison

Arethusa Collective Farm is a 14-acre organic farm in Burlington's Intervale that sells vegetables wholesale, through the Burlington Farmers Markets, and through its Community Supported Agriculture (CSA) program. It is an unusual operation – not because of the crops raised or the agricultural methods used, nor because of its CSA – but because of how its ownership and operations are organized.

Arethusa has a worker-cooperative structure, designed for those interested in practicing democracy in the workplace. Cooperative members must be able to express their ideas clearly, listen respectfully and patiently to others, and be willing to bend. Vermont farmers have a history of making democracy work well in small groups — at town meeting. The farmers of Arethusa are attempting to transplant that tradition to the farm operation itself. For anyone interested in sharing responsibility, ownership, and decision-making, Arethusa represents a model

worth considering.

Here's how Arethusa's four farmer-owners describe themselves and their farm on their website:

We are Jeremy Ward-Migner, Carol Hinrichsen, Ben Dana, and Thomas Case, a four-member, worker-owned farm collective. We have 14 acres in Burlington's Intervale along the Winooski River <http://www.intervale.org/index.html>. We share all the risk, responsibility, and profit of the farm, as well as the fun and joy of an agricultural lifestyle.

In addition to our CSA, we have a farmstand at the Burlington Farmers Market in City Hall Park on Saturdays from June through October. You will also find our produce at local stores such as City Market <http://www.citymarket.coop>, Healthy Living <http://www.healthylivingmarket.com/index.htm>, and Shelburne Supermarket and at restaurants including Stone Soup, Sugarsnap <http://www.sugarsnap.biz/>, Sirloin Saloon, New England Culinary Institute, American Flatbread, and Café Piccolo. Scrumptious Café [\[scrumptiousvt.com\]\(http://www.scrumptiousvt.com\), Sweetwaters <http://www.foodremembers.com/history/history.html>.](http://www.</p></div><div data-bbox=)

History

Arethusa Seed Farm was started in 1999 in Bakersfield, Vermont, by Thomas Case and Alice Stokes. In 2002, Thomas and Alice, now in partnership with Ben Dana, moved the operation to leased land in Burlington's Intervale, with a new focus on marketing vegetables, rather than seeds. When Jeremy Ward-Migner and Carol Hinrichsen decided to join Thomas and Ben and Alice decided to step back, the group decided it was time to reorganize.

With a bit of funding from the Intervale Foundation's Success on Farms program, the group found their way to the Vermont Employee Ownership Center (VEOC). To VEOC staffer Don Jamison, the group was already functioning as a worker-cooperative in many respects. Creating a formal co-op would solve some of the problems the group had already encountered or anticipated. He recommended an

attorney, Mark Saunders of Shems, Dunkiel, Kassel & Saunders, who helped them create co-op bylaws and, in the summer of 2004, Arethusa Collective Farm was incorporated.

How the Worker-Cooperative is Designed to Work

Arethusa's bylaws provide a roadmap for how someone becomes a "member" (i.e. an owner, in co-op lingo), members' rights and responsibilities, the role of the Board of Directors, how profits and losses are distributed, and what happens when a member leaves. At Arethusa, full- or part-time employees are eligible to apply for membership after one year of work on the farm. Upon acceptance of their application by the board, they become a member after purchase of a membership share (currently valued at \$1,000). Members elect the Board of Directors on a one-person/one-vote basis. The board is responsible for policy-level decisions. It distributes profits and losses to a retained earnings account and to

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LEGAL STRUCTURE OF THE FARM BUSINESS

Case Study: Group Ownership at Arethusa Collective Farm (continued from page 23)

individual members in the form of cash and/or credits to their internal accounts. Profits are distributed to members in proportion to the amount of labor they have contributed over the course of the previous year. After a member leaves, the cooperative buys back their member share and pays out the balance accrued in their account.

Operations at Arethusa

Carol Hinrichsen reports that the Arethusians have had their struggles with decision-making, but have gradually gotten good at figuring out which decisions require everyone's involvement and which can be delegated. They also have

experimented with matching members' skills and interests with the jobs that need to be done. Carol, for example, had primary responsibility for PR during the past season, worked in the greenhouse, shared responsibility for bookkeeping with Thomas, did some of the calling for the wholesale side of the business, and did a share of the job she likes least – making deliveries. The members are contemplating some changes for next year – a different distribution of duties, a greater focus on some parts of their business, and possibly eliminating others.

Challenging as it's all been, it has also been very rewarding. Carol recently had a part-time job in a more conventionally-

structured business and says, "I've gotten used to people caring about what I think about my work. It was weird just getting directives and carrying them out, without discussion before or after. Talking things over with those you're working with, feeling that your opinion matters and can actually change things – it all just feels like the way it's supposed to be."

Contact Information:

Arethusa Collective Farm

P.O. Box 8082, Burlington, Vermont
05402

802-578-6429

www.arethusacollectivefarm.com

arethusacollective@yahoo.com

Questions on worker cooperatives and other forms of employee ownership can be directed to:

Vermont Employee Ownership Center

P.O. Box 546, Burlington, VT 05402

802-861-6611

www.veoc.org

info@veoc.org



LEGAL STRUCTURE OF THE FARM BUSINESS

Creating a Limited Liability Company (LLC) - The Nitty-Gritty Details

By Beth Kennett, Liberty Hill Farm, Rochester, Vermont, with Bob Parsons, University of Vermont Extension, and Jesse Richardson, Virginia Tech

If you are contemplating expanding or transferring your farm or starting a new farm business, you are likely to be also considering an appropriate business entity for this change. Business entities include the sole proprietorship, partnerships, limited liability partnerships, corporations, and limited liability companies (LLCs).

The first huge task involves working with an attorney and accountant to

choose the right business structure for your family's farm. You then go through a detailed and agonizing process to develop a business plan and legal agreement according to state law that addresses the specific circumstances of your farm. Now you think you are almost done.

At this point, you could think that you were almost finished. But the job is only half over. You have the agreement, but

now you have to implement the birth of a new business entity. These steps involve myriad details that need to be completed to actually transform your sole proprietorship farm (Mom and Dad's farm) into the new entity as determined by your business agreement.

Once you have completed the necessary details of working with an accountant and an attorney, you still have

to accomplish an extensive "to-do" list. This list is a compilation of the "other" stuff that comes with forming a new business entity. An example of such a list follows. This example is based on forming an LLC, although most of the listed steps are similar, no matter what the entity. Note that the list is not exhaustive; different farms and situations require other items.

With Whom	To Do	How Long
Secretary of State (Contact official/agency. This varies from state to state)	File Articles of Organization with the Vermont Secretary of State's office. The Secretary of State's office will send your Certificate of Organization so recognized. Keep these documents in a safe place. You may also register a trade name. Your attorney can file for the trade name. You must include a filing fee to the state. In Vermont, the fee is \$75 for the LLC and \$0 for a trade name registration. Your attorney may advise you to purchase a corporate book that costs approximately \$100. Retain records of the corporation in this book.	From ten days to two weeks to receive notification that your business name is accepted.
IRS/Federal Business ID number	Apply for a tax identification number on Federal Form SS-4 Employer ID Form (follow directions exactly). You will receive confirmation of your number via email and documents will subsequently arrive via mail	Online: 20 minutes to 2 hours. Mail can take 3-4 weeks.
Bank (Set up new accounts for the LLC) Need Federal ID number (May put "applied for" if you have not yet received the number) and the exact name of the business.	Photo identification needed at bank. Bank needs information: - Routing number of bank to order checks, - Account number for new LLC account, - Decide on balance transfers, - Electronic transfers for direct deposit and automatic payment deductions, - Set up on-line banking, and - Assignment of overdraft protection to accounts.	Up to a couple of days, depending on bank.



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With Whom	To Do	How Long
Purchase new checks —must have LLC name printed on them	Computer checks for payroll Business checks for vendors Need bank routing number & account number. Need bank routing number & account number	Can take from 3 days to 3 weeks.
Milk checks or other income checks	Establish new member ID number. Documents needed: - Business ID number, - Copy of names of LLC owners, - Bank information: routing number & account number, and - Voided bank check. Decide on equity issue with coop. (Will benefits of equity established by parents go to parents or to the new business entity?)	Process takes approximately 2 weeks before check comes to LLC.
Lending institutions	Establish which liens will remain with individuals and which are reassigned to new entity. Contact mortgage holders to determine what paperwork they will need before approving any real estate transfer. Check with mortgage insurance holders. Contact lien holders of equipment, livestock, and other property to determine what paperwork they will need before approving an ownership transfer. Contact lenders, lien holders, suppliers, and others who have an assignment from product sales such as milk checks. Note: If you are transferring property with liens or mortgages, including real estate, equipment, or livestock, to the new entity, you will need consent from the lien holder prior to the transfer.	1 to 2 weeks
Insurance	Decide which insurance is paid by new entity - liability, fire, vehicle, comprehensive. Notify insurance agent of LLC change. Reassign automatic payments to new bank account. Workers' Compensation may need to be changed. Alter disability insurance if family members move from workers to owners. Term life insurance – take out cross-insured policies on members to protect LLC and allow the fund to purchase farm from heirs. Note: For liability insurance, have entity and all individuals involved named as co-insured. There should be no extra charge for this.	



LEGAL STRUCTURE OF THE FARM BUSINESS

With Whom	To Do	How Long
Vendors	<p>Notify those vendors that utilize the business ID number for tax purposes.</p> <p>Purchase stationary with LLC letterhead.</p> <p>Some vendors (feed, seed, or fertilizer) may require additional paperwork with new LLC due to collateral and credit issues.</p> <p>Vendors who are paid by automatic payments need bank routing numbers.</p>	
Payroll	<p>Members of the LLC are no longer employees, so payroll status must change.</p> <p>Employees must be paid with LLC check assigned to Federal ID number.</p>	
Farm Service Agency / Federal programs.	<p>Notify FSA office of change in ownership/operator status, new bank account numbers for direct deposit.</p>	
Lease agreement between parents of LLC	<p>Clearly define what property is owned by entity and what property is owned by individuals.</p> <p>Determine who is responsible for mortgage, property taxes, insurance, and maintenance.</p> <p>Allow provisions for credit of improvements in case of dissolution.</p> <p>LLC must maintain appropriate insurance as operating expense.</p> <p>Document lease agreement between LLC and parents/family owners.</p>	
Credit card for LLC	<p>Set up bank or other entity for purchases.</p> <p>Identify which purchases can be automatic on credit cards (vet, supply vendors, office items, phone, Internet).</p> <p>Set up separate credit card account for entity.</p> <p>Keep personal items from LLC to maintain corporate veil.</p>	
Transferring property	<p>Transfer property that you wish to transfer to entity.</p> <p>Real estate will need deeds and be completed at town office/recorder office.</p> <p>Vehicles can be transferred at your state agency of motor vehicles.</p> <p>Document the sale/transfer of any personal or business property with a bill of sale.</p>	
FILE RECORDS IN FIRE-SAFE BOX!!!		



LEGAL STRUCTURE OF THE FARM BUSINESS

Raising Capital Using the LLC Structure

LLCs offer enormous flexibility in terms of allocating management control, rights to income, and other ownership rights. An LLC operating agreement can create several different types of membership and ownership classes. This flexibility provides some opportunities for using the LLC structure to raise capital from interested investors or even interested community members wishing to support local agriculture. A class of membership units can be offered that offers only an income or an economic interest but has no rights to management. Transfers can also be restricted. For management and tax purposes, these units may mimic an interest of a limited partner. The operating agreement may dictate a particular holding period for investors or may allow the business to redeem (repurchase) the units at some specified point in the future.

Under Vermont law, a membership interest in a limited liability company is considered a “security.”²⁸ Sales of membership interests in a farm LLC to community members or investors need

to comply with the state and federal laws that regulate the sales of securities. The intent of securities regulation, also called Blue Sky laws, is to protect the public from fraudulent sales of worthless securities. The Vermont statute requires that certain securities and certain securities transactions be registered with the Department of Insurance and Banking. The registration process requires detailed financial information about the business and also involves review by the state to ensure that the offering is fair — has merit — for potential investors. Securities brokers and dealers must also register with the state.

There are, however, several exemptions from the need to register for certain kinds of security sales. Three exemptions that may cover most small offerings are discussed below. Even if the sales fit within one of the exemptions, however, the law still requires certain disclosures to potential investors in the form of a prospectus or an offering brochure.

A. The Limited Offering Exemption

Any sale of securities by an issuer to not more than 25 people in the state of Vermont during any period of 12 consecutive months is exempt from registration, if:

The seller believes the buyer is purchasing for investment — that is, the buyer will hold the interest for a lengthy period as an investment.

No commission or other remuneration is paid or given directly or indirectly for soliciting any prospective buyer in the state.

No general advertising is published or circulated with any such sale.

Sales of membership units to fewer than 25 Vermont investors do not require registration, either. You may not solicit investors by advertising in the newspaper or on a list-serve, but you may solicit investors by mail if the solicitation is addressed to specific individuals. There is no limit to how much money can be raised under this exemption, and there is no pre-proscribed form of offering document — called a prospectus — required. However, sellers must disclose “all material information” about the

business. That term means all of the information necessary to allow investors to make an informed decision about whether or not to invest. As well, verbal statements made about the business must match the written statements.

B. The Vermont Small Business Offering Exemption (VSBOE)

For sales of LLC units to more than 25 investors but fewer than 50, the Department of Insurance and Banking has provided another exemption by administrative rule. The requirements, however, are a little more onerous and complex. **Some of the requirements are as follows:**

- The LLC’s principal place of business and 80 percent of its assets are in the state of Vermont, and at least 80 percent of the proceeds from the offering will be used for Vermont operations.
- The aggregate offering may not exceed \$500,000.
- The duration of the offering may

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LEGAL STRUCTURE OF THE FARM BUSINESS

Raising Capital Using the LLC Structure (continued from page 28)

not exceed 12 months – unless an extension is filed.

- No commission, fee, or other remuneration may be paid to any person for soliciting potential purchasers.
- The offering document must contain certain pre-prescribed language in bold print warning that the investment carries significant risks and that there are restrictions on transfers.

The LLC must also file copies of all advertising and a report on the sales that were made with the Department of Insurance and Banking and pay a \$200 filing fee.

C. The Accredited Investor Exemption

By rule, the Commissioner of Banking, Insurance Securities and Health Care Administration has also exempted the sales of securities to certain types of investors, called “accredited investors,” from the registration requirements. This rule exempts sales to purchasers

deemed sophisticated enough to evaluate the merits of the particular investment on their own. **A sale is exempt if you reasonably believe that:**

- The purchaser is a person whose individual net worth, or joint net worth with that person’s spouse or civil union partner at the time of his or her purchase, exceeds \$1,000,000, or
- The purchaser is a person who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with a spouse or civil union partner in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.

You must also reasonably believe that the accredited investors are purchasing the interest as an investment and not for resale. **For this exemption, you may publish a general announcement of the offering but**

it may contain only the following information:

- The name, address, and telephone number of the issuer of the securities;
- The name, a brief description, and price (if known) of any security to be issued;
- A brief description of the business of the issuer in 25 words or less;
- The type, number, and aggregate amount of securities being offered;
- The name, address, and telephone number of the person to contact for additional information; and
- A statement that:
 - Sales will only be made to accredited investors;
 - No money or other consideration is being solicited or will be accepted by way of this general announcement; and
 - The securities have not been registered with or approved by any state securities agency or the U.S. Securities and Exchange Commission and are being offered

and sold pursuant to an exemption from registration.

You may provide additional information to the investor only if, after inquiry, you reasonably believe that the potential purchaser is an accredited investor. You must also file a notice of the transaction, a copy of the general announcement, and a \$200 filing fee with the Commission of Banking, Insurance Securities and Health Care Administration.

Federal Exemptions from the Registration Requirements

The federal exemptions from registration with the Securities and Exchange Commission (SEC) mirror the state exemptions to some extent, but they are enormously complicated. It’s simplest to stay within the federal “intrastate offering exemption.” If most of your business is conducted in Vermont and you make offers and sales only to residents of Vermont, you don’t have to register at the

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LEGAL STRUCTURE OF THE FARM BUSINESS

Raising Capital Using the LLC Structure (continued from page 29)

federal level. The purchasers, however, may not resell to anyone out of state. The LLC units should specify these restrictions on re-sale and include other restrictive language intended to keep the sale within federal regulations.

If you intend to sell securities outside the state of Vermont the federal Securities and Exchange Commission provides a wealth of advice for small business at: <http://www.sec.gov/info/smallbus.shtml>. A description of the federal exemptions from registration can be found at: <http://www.sec.gov/info/smallbus/qasbsec.htm#eod6>.

Additional Anti-Fraud Provisions

Even if the offering fits within one of the exemptions listed above, it is still subject to the general anti-fraud provisions of the Vermont Securities Act. This act prohibits:

(a) In connection with the offer to sell, a sale, an offer to purchase, or the purchase of a security, a person may not, directly or indirectly: (1) employ

a device, scheme, or artifice to defraud; (2) make an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or (3) engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon a person.

Except as noted above, there is no particular format required for the information (prospectus) that you give to prospective investors but the SEC does say that issuers should “attempt to balance any discussion of the potential rewards of the offering with a discussion of possible risks.” In addition, “issuers should take care to ensure that oral statements to prospective purchasers about the offering are consistent with the disclosures contained in the offering document.”

A Farm Prospectus

An offering prospectus for a farm LLC might contain the following:

- A general description of the farm operation.
 - Farm plan for the next 5 years.
 - Goals of the farming enterprise.
- Management practices that distinguish the enterprise.
- Financial aspects including the offering cost of each unit to be sold, terms of the sale, and specifically how the proceeds from the sale will be used. Expected return on the investment from both income and appreciation. Potential tax aspects of income/expenses to LLC members.
- Expectation with respect to holding period of the investment. Rights to transfer and any restrictions on right to transfer interest (only to Vermont residents, for example). How the interest will be valued. Potential risks associated with expectations for income and appreciation.
- How the LLC will be managed. Voting rights and how decisions will be made.
- Risks to operation and to the investment.

- Requirements that investors must meet to comply with state and federal securities regulation (income, assets, residence, sophisticated investors).

The federal exemptions from registration with the Securities and Exchange Commission (SEC) mirror the state exemptions to some extent, but they are enormously complicated. It's simplest to stay within the federal “intrastate offering exemption.” If most of your business is conducted in Vermont and you make offers and sales only to residents of Vermont, you don't have to register at the federal level. The purchasers, however, may not resell to anyone out of state. The LLC units should specify these restrictions on re-sale and include other restrictive language intended to keep the sale within federal regulations.

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LEGAL STRUCTURE OF THE FARM BUSINESS

Raising Capital Using the LLC Structure (continued from page 30)

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- How the LLC will be managed. Voting rights and how decisions will be made.
- Risks to operation and to the investment.
- Requirements that investors must meet to comply with state and federal securities regulation (income, assets, residence, sophisticated investors).

Farm Transfer and



Estate Planning

By Annette Higby



FARM TRANSFER AND ESTATE PLANNING

Farm succession — the transfer of the farming enterprise from one generation to the next — is most often a gradual process. The traditional progression begins with a transfer of labor and farm income, then a gradual transfer of management and control, and eventually the transfer of farm assets — first farm chattels such as livestock or farm equipment and then farm land. In practice, the progression is rarely a neat and orderly process. Each family follows its own course, and some never take the next or final step of the transfer of farm assets.

The pace and progression of farm succession is necessarily dictated by the arc of the business, the size of the estate, the mix of farm and non-farm assets, the retirement needs of the senior generation, and the personal goals and objectives of each generation as they mature. Equity for non-farming heirs is also a consideration. Because all of these factors change over time, an estate plan or a farm succession plan is never “done.” At best, it is a current snapshot of a plan to transfer the business given the current circumstances.

In the case of a transfer outside the family, there is no “traditional” progression to follow. Those who bring a non-family member into the business

are blazing a new trail entirely. In these cases, it’s even more important to foster good discussion and define and document the rights of the parties by using legal tools such as leases; milk, livestock, or crop share agreements; and partnership or some other business operating agreements.

Farm succession inside or outside the family can be a difficult topic for families. It raises issues of changing roles, money, and death.¹ These issues are intensely personal — even painful. It’s easy to be overwhelmed.

Ideally, the first conversation about farm succession should occur long before the new partner or partners are brought into the business. Once the parties are ready to explore the legal tools to formalize the relationship, the basic business agreement — the operating agreement in the case of an LLC or a partnership agreement, for example — can provide attorneys and other service providers with a framework for discussion about the division of labor, how management decisions will be made, how control of the business will be allocated, the division of income, and the ownership of business assets.

The business agreement should also address issues of a buyout of the business interests of any partner who might wish to leave the business or withdraw from it. Therefore, the agreement

should provide some means of periodically valuing the business. It should also address how and whether the business will continue in the event of the death or disability of a partner or member.

The value of the business should be reviewed annually, along with a review of each partner’s capital account or other measure of ownership at tax time. An annual discussion regarding how and whether the junior generation’s ownership interest should increase is useful, and non-farm heirs should be informed about anticipated changes in ownership of the farm business. It’s also essential to hold regular family business meetings to discuss cash flow and make decisions regarding capital expenditures and other farm management issues. These practices will set the stage for healthy, ongoing communication and a successful farm business succession.

Along with the personal issues, farm succession can involve a complex set of business, tax, and legal issues. It’s a rare attorney, accountant, or cash flow analyst who can address all these needs. Successful farm succession may require a team of professionals, although the overall process must be family- and farmer-driven. When it comes time to put all the pieces of the puzzle together, the farmer is the only expert.



Lifetime Transfers of Livestock and Farm Equipment by Gift

Making an effective lifetime gift of an asset requires: 1) some act indicating an intent to make a gift immediately and irrevocably, 2) unconditional delivery or divestiture of the asset, and 3) acceptance by the receiver of the gift.² Where there is intent and unconditional delivery, acceptance can be presumed. Absent duress or incapacity, once a lifetime gift is made, you can't "take it back." Lifetime gifts of farm assets must be considered very carefully. Assets needed to fund retirement, including any health care needs that may arise, should not be gifted. The tax consequences of gifts for both the giver and the receiver should also be considered carefully.

On the other hand, making a lifetime gift of farm assets to the next generation can often make good economic sense. Gifts that improve the creditworthiness of the successor, for example, can facilitate the purchase of the balance of the assets by the successor. A gift of breeding stock can help the successor begin building equity in the offspring. A gift of an income share in the farm business gives the heir an opportunity to build equity by reinvesting a portion of that income back into the farm business. This gifted and earned equity can provide the collateral necessary to finance a buyout of the balance of the business. It can also lead to an attitude change – a successor with an equity stake in the business will work and contribute in ways quite different than a mere employee.

Gifts may also make sense from an estate tax perspective. Those with estates in excess or within

“ Making a lifetime gift of farm assets to the next generation can often make good economic sense.

striking range of the estate tax may want to consider making gifts. For these estates, gifts put assets immediately in the hands of heirs; reduce the size of the estate, and ultimately, reduce the estate tax.

Gifts that exceed the so-called “annual exclusion” amount, which for 2006 is \$12,000 or \$24,000 for a husband and wife, require that the giver file a gift tax return. Even if the gift does not exceed the annual exclusion, filing a gift tax return can provide documentation of the gift and establish a valuation for the asset. A gift tax return can also be filed to document sales of farm assets to family members. The value of filing a gift tax return in these instances is that it starts the three year statute of limitations on IRS challenges to valuation where there is “adequate disclosure” on a gift tax return. Adequate disclosure includes at the very least the method used to determine value. Use of any discounts must also be disclosed.

If the value of the gift does exceed the annual exclusion amount, this doesn't mean that there will be a gift tax due. The amount above the annual exclusion amount can be applied against the giver's lifetime unified credit. There is, however, a lifetime limit on gifts of \$1,000,000. There is no gift tax consequence for the receiver of the gift. For more on the Annual Exclusion amount, see “Annual Gifting” on page 54.

Gifts receive a “carry over basis” meaning that the “giver's” basis in the asset carries over to the receiver of the gift. If the giver's basis in the asset



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is zero, the successor will also have a zero basis. When the successor sells the asset, he will have to report as income the difference between the sale price and the giver’s carry over basis. In this respect, a lifetime gift may not be as advantageous to the successor as transferring the same asset by Will or Trust—transforming it into a bequest rather than a gift. A bequest receives a “stepped up” basis equal to the asset’s fair market value at the time of transfer. There are, however, many good non-tax reasons to make lifetime transfers of farm assets.

Gifts should be well documented. For gifts of livestock or equipment, the giver should write a letter making an unconditional gift to the succe-

sor. The letter should note the value of the asset and the giver’s basis in the asset. Gifted livestock and their offspring should be tagged. Titled assets should be re-titled. Gifts can also be documented in a gift tax return. For gifts of \$5,000 or more, a gift tax return is a good idea.

Gifting assets will also have implications for Medicaid eligibility. Certain transfers for less than fair market value made less than 36 months prior to the date of application for Medicaid may result in a period of ineligibility. (See “Permitted and Penalized Transfers” on page 62.)

Tax Basis

	Lifetime Gift	Sale	Bequest
Transferee	Takes a carryover	Basis = Price	Basis = FMV on date of death (stepped up basis)
Transferor	No gift tax if less than annual exclusion/ lifetime exclusion	Recognition of gain	Potential for estate tax

Transfer of Livestock or Equipment by Sale

A sale of farm equipment and livestock to a successor may have unexpected tax consequences to the seller. The seller will have to pay tax on any “gain” realized from the sale of the assets with the gain being equal to the difference between the sale price and the adjusted basis of the asset. Long term capital gains are taxed at 15 percent. The sale of certain kinds of depreciable property used in the

farm business, however, may lead to the recognition of ordinary income. Ordinary income is taxed at the same rates as wage income at a rate that may be higher than the 15 percent capital gains rates.

Sales of farm machinery and livestock can result in significant tax liabilities. The amount of gain that must be reported as capital gain or as ordinary income depends on the type of asset, how long the

farmer has owned the property and the extent of depreciation allowed and allowable on the property. Farmers should not make sales of business assets to successors without first consulting a tax professional. Service providers should encourage farmers to get an estimate of the tax bill before the transfer is made and to factor the results into their retirement income planning.



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Combining a Gift and Sale of Livestock and Equipment

A sale of property on especially advantageous terms is part sale and part gift. The gift part of these transactions is subject to the rules on the annual exclusion amount and the lifetime unified credit described above.

If the interest rate charged on an installment note, for example, is less than the market rate of interest, the difference is considered by the IRS to be a gift. Every month the IRS publishes an “applicable federal rate” schedule for short, medium, and long term notes to provide guidance to taxpayers on market rates of interest. The applicable federal rate can be found on the IRS website at <http://www.irs.gov/taxpros/lists/0,,id=98042,00.html> If the inter-

est rate on the installment note is below the AFR, the transaction is, in part, a gift. These rules apply for both family and non-family transactions.

A sale of the farm asset for less than fair market value is also part gift. It's essential that every basis for valuation of the asset being transferred within the family be well documented. Valuation can be established by using an asset's book value or by an appraisal. A farmer may also use his or her own knowledge of what comparable assets are selling for in the community and include those comparable sales in the letter making the gift. If the value is discounted for any reason, it should also be documented in a gift tax return that includes

an appraisal. A bargain sale can give the successor a better basis in the property than an outright gift and can also reduce the capital gain to be recognized by the seller.

An installment sale may be intentionally structured as part gift and part sale. A seller who cancels payments as they become due is making a gift of the payment. These transactions should be documented by a letter that cancels and gifts each payment. The cancelled payments, whether in excess of the annual exclusion amount or not, may be documented using a gift tax return. Filing a gift tax return would start the three year statute of limitations on any IRS challenge to value.

Leasing Farm Equipment and Livestock

Leasing can avoid some of the tax consequences of an outright sale of farm assets. Because there is no transfer of the underlying asset, there is no capital gain to be recognized. There is, however, an income tax consequence and in some cases, a self-employment tax consequence from rental income. For more on agricultural land leases and the tax treatment of rental income, see “Agricultural Leases” on page 70.

Leasing an income-producing asset such as cows

or equipment can provide a successor with an opportunity to build equity by reinvesting a portion of the income in additional income-producing assets. A livestock lease can be structured as a “share lease” where an owner and lessee split income and expenses along an agreed upon percentage. A livestock share lease is especially advantageous for low-equity successors with limited operating capital because the up-front operating costs are shared along with the resulting income. The livestock lease may

also be a simple, straight-cash rent per head rather than a share lease. A cash lease requires a successor to make an up-front cash payment. A lease arrangement, however, can be structured as a part lease and part gift if the rental payment is less than a fair market rental.

Livestock that has been gifted to the successor may also be leased back by the farm, thus providing income to the successor to re-invest in additional livestock or other farm assets.



Transferring an Interest in a Farm Business

The traditional progression of farm succession is to transfer the farm business long before the farmland changes hands. Where there is a joint farming operation with a successor and where financially feasible, a transfer of shares or an interest in the farm business, rather than a piecemeal transfer of assets, makes the most sense. Restating your partnership agreement, amending your operating agreement, or even choosing a new legal structure all together may be the first step in transferring the farm business.

The legal structures most appropriate to use for the transfer of a farm business will allow you to easily value, track, and transfer an interest in the farm business. Legal structures such as Limited Liability Companies, Corporations, Partnerships, and Limited Liability Partnerships make it easier to track ownership and income and can therefore facilitate a gradual farm transfer. In these structures, farm assets are reduced to “units” or “shares” or a capital account, facilitating a gradual transfer to a successor. These structures can also provide a gradual transfer of management and control of the farm operation. There are other considerations, however, in choosing an appropriate legal structure. For more on the legal structure of the farm business, see Chapter I, “Legal Structure of the Farm Business.”

When transfer of the farm business is a primary objective, certain elements of the partnership or

other operating agreement of the business become essential. **The following elements are of particular concern.**

Rights to Income

Rights to income from the farming operation needn't be divided strictly on the basis of ownership. Where a successor is contributing significant labor, the business agreement may provide for an income share proportionately greater than the successor's ownership interest in recognition of that contribution.

Income paid to the senior generation no longer involved in the management of the business may also be structured to avoid self-employment tax.

Rights to Management

The legal structures suggested above will, in varying degrees, allow the senior generation to retain or gradually transfer management control while transferring a significant ownership share to a successor. A partnership agreement, for example, may lodge control in the partner who owns the majority of the capital interest in the partnership. A limited liability company may initially issue only non-voting units to a successor, retaining voting control in the senior generation until the successor has the necessary management expertise to take over.

Control can shift over time as ownership shifts in favor of the successor. These shifts can be accomplished through periodic review and amendment of the business agreement.

Mechanics of Transferring an Interest in the Farm Business

Certain legal structures – the limited liability company and the corporation, for example – reduce farm assets to units or shares, making the transfer of ownership fairly simple. Units or shares can be gifted or sold to a successor. Valuation is accomplished by a periodic appraisal of the farm assets. The assets' aggregate value divided by the number of shares or units issued is the per-share value. If units are gifted and the value of the gift exceeds the annual exclusion amount explained above, a gift tax return must be filed. It's good idea to file a gift tax return even if the gift does not exceed the annual exclusion amount as documentation of the gift and its value.

A farm partnership can also facilitate transfer but instead of tracking shares or units, the partners track capital accounts. A gift of an income interest in a farm partnership can allow the successor to build equity in the business by reinvesting income back into the partnership, thus growing the business.

For example, Grandmother gifts her 25 percent capital share in the family farm partnership to her



granddaughter who begins farming in partnership with her father who has a 75 percent share. The partnership agreement provides that profits and losses will be shared between father and daughter, fifty/fifty. Rather than taking her full income share each year, she reinvests a portion of it in the farm business, gradually building up her capital interest in the business while increasing the farm's profitability and capital.

It is rarely, if ever, a good idea to transfer an ownership interest in the farm business to non-farm heirs. If the shares come with management rights, such a transfer can cause a great deal of friction with respect to distribution of income and reinvestment of capital. If the shares come without management control and no rights to transfer out of the family, there is potential for resentment. There are better ways to provide for non-farm heirs. See for example, the Buy-Sell

The farmland is most likely the farm family's most prized and most valuable asset. Its disposition can present one of the most emotional aspects of farm succession and estate planning for both generations. In some families, the farm is divided equally among all the heirs – farm and non-farm alike. In other families, the farm goes to the farming heirs. Some families accomplish this transfer while the heirs are quite young. Others transfer the farm by Will or in Trust only after the deaths

Agreement below and “Ways to Provide for Non-Farm Heirs,” page 45.

The Buy-Sell Agreement

A buy-sell agreement can be used to protect the heirs of the partners and to ensure a smooth transfer of a deceased or disabled partner's share in the business to the remaining partners. A buy-sell agreement provides for stable continuity of the business without a threat of termination upon the death, disability, or withdrawal of a partner.

In essence, a buy-sell agreement is a provision within the partnership agreement that obligates or provides an opportunity for the surviving partners to buy, and the deceased partner's estate to sell, the deceased partner's equity in the partnership. A buy-sell agreement can also be used to prescribe the terms of a buyout of the business in the event

Transferring Farmland

of the senior generation. No matter how the farm is transferred, these choices have emotional, legal, and tax consequences for both the transferee and the transferors.

Mechanics of Transferring Farm Land

Lifetime transfers of farmland by gift or by sale to a successor generation are eased by first transferring

of disability or withdrawal of a partner.

A buy-sell agreement should provide a means for valuing the deceased partner's share. Valuation can be accomplished by an appraisal or by using the periodic valuation of the partnership assets by the partners. Annual valuations of the business by the partners as part of the annual review of capital accounts are a good idea, in any event.

A buy-sell agreement may also provide repayment terms for the surviving partners including any necessary down payment, a formula for determining the interest rate, and other terms. An installment buyout can provide income to a surviving spouse.

Buy-sell agreements can also be funded through life insurance. A policy on the life of each partner can be purchased for the benefit of the surviving partners and the proceeds can be used to buy out the deceased partner's share.

the farm into an entity that allows you to value, track, and gradually transfer interests over time. A Limited Liability Company, for example, will reduce the asset to “units” that may be gifted over time. The gifts can stay within the annual exclusion amount or the transfer can be accelerated by using up some of the senior generation's unified credit. There is, however, a lifetime gifting limit of \$1,000,000. As with the transfer of other farm assets, the gift should be documented by filing a



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gift tax return. It's wise to appraise the farm every two to three years to back up the value used in the gift tax return. Any discounted valuation must also be backed up by a discount appraisal. (See "Discounted Valuation for Minority Interest and Lack of Marketability" on page 56.)

If you place a residence into an entity such as a limited liability company, you may lose your right to claim it as a homestead. You may also lose important tax benefits allowing the exclusion of gain on the sale of a principal residence. For those reasons, it may be best to leave a residence out of the entity and to transfer it separately (See "Re-titling Assets to a New Entity" in Chapter I, Legal Structure of the Farm Business on page 13.

Transfers by Sale

Exclusion of Gain on the Sale of a Principal Residence

A lifetime transfer of the farm by sale can have significant tax consequences. If the farm was purchased many years ago, it is likely to have a low tax basis. If the fair market value of the farm exceeds its tax basis, the transfer will result in taxable capital gain. The tax code offers an exclusion of up to \$250,000, or \$500,000 for qualifying married couples who file jointly, of gain for property that has been owned and used by the taxpayer as the taxpayer's principal residence.³ Taxpayers must have occupied the property for at least two out of the five years prior to the sale. The exclusion can be used every two years. Only the homestead portion of the farm property will qualify. The farm-

land and any other property used for business purposes are not eligible for the exclusion.

Section 1031 – Like-Kind Exchanges

The tax code also allows a deferral of the recognition of gain for certain like-kind exchanges of property. Property held for productive use, such as a farm, or property held for investment if exchanged solely for similar property can defer recognition of gain. Like-kind is interpreted very broadly – just about any other interest in real estate will qualify provided it has a productive purpose. A principal residence, for example, would not qualify.

The farm owner can make an actual swap with another owner of like-kind property under Section 1031. The farm owner can also sell the farm, place the sale proceeds in escrow, identify a like-kind property within 45 days, and purchase the like-kind property within 180 days of the sale. Any proceeds that are not used to purchase the replacement property will be subject to capital gain taxation.

Capital gain is deferred only under a Section 1032 like-kind exchange. In this situation, the farm owner's basis in the original farm is carried over to the replacement property. When the replacement property is sold, the resulting gain must be recognized.

Installment Sales

Farmers who sell their farm land under an installment contract such as a contract for deed may elect to report any gain using an installment method. Each payment received is reported as part in-

come, part gain, and part a return of basis in the property. To calculate the gain portion, take the contract price less the expenses of the sale and less the adjusted basis in the property. This is the gross profit, or the total gain from the sale. Determine the gross profit percentage by dividing the gross profit by the total contract price. For example, if the total contract price is \$500,000 and the gross profit is \$350,000, the gross profit percentage is 70 percent. (\$350,000 divided by \$500,000.) After subtracting the interest portion of each installment payment, 70 percent of the balance of the payment is reported as capital gain.

Easing Farm Land Transfer Using a Conservation Easement

Probably the biggest barrier to an outright sale of farmland to a farming heir is farmland affordability. When sold as part of a farm transfer plan, a conservation easement can reduce the sale price the new operator pays without reducing retirement income for the selling farmer.

A conservation easement is an interest in land. It is recorded in the town land records just like a deed. A conservation easement restricts the development of the property while allowing agricultural and/or forestry uses. While there are some common aspects to a conservation easement, each is unique to the farm it conserves. For example, some easements allow future development on well-defined house sites while restricting the bulk of the property to agricultural uses.



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A conservation organization may purchase a conservation easement or the easement may be donated by the landowner. Funding for easements comes from state and federal funds, private foundations, and local fundraising. Easement holders in Vermont – those who must enforce the easement - include the Vermont Agency of Agriculture, the Vermont Housing and Conservation Board, and private land conservation organizations such as the Vermont Land Trust and the Upper Valley Land Trust.

Funds that come from state and federal sources are administered by the Vermont Housing and Conservation Board (VHCB). VHCB has set dollar limits on a per-acre and per-project basis, however funds from other sources make it possible for projects to be funded in excess of these caps. Farms must also meet certain criteria to be considered eligible for conservation funding. For a good description of these criteria, go to VHCB's website at: <http://www.vhcb.org/conservation.html#Anchor-Farmlan-65515>.

Farms first go through a pre-application process with VHCB. The pre-application must be sponsored by a land conservation organization or the Vermont Agency of Agriculture. Farms with prime agricultural soils, located in a farming area potentially threatened by development pressure, with a good infrastructure, and under sound resource management are given priority.

Other factors can also enhance an application for conservation. Private land conservation organizations, for example, like to see a local financial

contribution from a town conservation fund. A promise by the landowner to provide public recreational access can also enhance an application.

The value of an easement is determined by an appraisal prepared by a certified appraiser. The appraisal sets a value on the farm “before the easement” and a value for the farm “after the easement.” The value of the easement will be the difference between this before and after value. In the farm transfer context, the new operator will pay the farm owner the after-value of the farm and the conservation organization will pay the farm owner the difference between the before and after value. For an example, see the case study by Alex Wylie of the Vermont Land Trust on page 41 of this chapter.

Easements with an Option to Purchase at Agricultural Value

By stripping the development value from the purchase price, a conservation easement brings the sale price a bit closer to the amount a farmer can pay for the farm with farm income. Some conserved properties, however, attract estate buyers who are willing to pay a much higher value. These estate sales can take conserved farmland out of the agricultural market by pushing the “after value” well out of reach of local farmers.

To counter this trend, the VHCB and private land conservation organizations have begun using a new tool for properties with potential estate value and for some “bare land” projects. The new

tool is a special kind of option to purchase the conserved property. The option is included in the conservation easement and it gives the land trust organization the option of stepping in and purchasing the property should it be offered for sale to a non-farmer, who is defined as someone who doesn't derive at least 50 percent of his or her gross income from farming. The option does not apply to sales within the farm owner's family or to another farmer.

If the land was to be sold to a non-farmer and is likely to be taken out of agricultural production, the option holder is able to step in and buy the farm for resale to a farmer.

The option price that the conservation organization will pay is based on a formula aimed at determining the property's value if its highest and best use is agricultural production. The option to purchase at agricultural value, or OPAV, sets an option price as the greater of:

- The agricultural value of the property as determined at the time the easement was purchased, adjusted for inflation, or
- The agricultural value of the property as determined by an appraisal at the time the option is to be exercised.

For whole-farm conserved properties that include farm improvements and a residence, the formula adds a value for these structures to the agricultural value of the land in order to obtain the full agricultural value of the property. For farm improvements, the value is



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determined by a “cost approach” method appraisal. For the farm residence, the contributory value is the cost or replacement value of the residence.

Easing Farm Transfer using an Option to Purchase at Agricultural Value

If an OPAV may be used, the appraisal conducted at the time of conservation includes three different appraised values: the “before the easement” value; the “after the easement” value without an OPAV; and the property’s agricultural value, which is its value assuming that its highest and best use is agricultural production. Adding an OPAV to the easement can further reduce the purchase price a farm successor pays. An OPAV also increases the price the farm owner receives for the easement. The OPAV should open up affordable farm purchase options for farmers.

Tax Implications of Conservation Easements

Sellers of a conservation easement are allowed to defer any gain on the sale. The sale proceeds may be applied against the property’s tax basis. This reduction in basis will result in a larger gain if the property is later sold. If the sale proceeds from the sale of development rights exceed the property’s basis, however, then gain will have to be recognized to the extent of the difference. **For example:**

Example 1:

A owns farmland with a total adjusted basis of \$200,000 and a fair market value of \$600,000. A sells a conservation easement on the property for \$200,000. The full \$200,000 realized from the

sale of a conservation easement is applied against A’s basis leaving A with a zero basis in the farm. If the property is later sold A will have to recognize the difference between his basis (zero) and the sales price as gain.

Farm Transfer and Farm Conservation Case Study

By Alex Wylie, Vermont Land Trust

Joe and Marilyn Hand have been leasing the Quinn Farm for 10 years. Starting with the calves that Joe was given as part of his pay when he was working for a neighbor during high school, they have been able to build up a nice herd of 75 cows and young stock in this time. They also own a tractor and manure spreader. The farm owner’s health is deteriorating and she has decided that she wants to sell the property and move to Florida to be near her daughter. The Hands would love to own the Quinn Farm, but they can not afford the \$625,000 price tag. While discussing their financial realities, their banker suggests that the Hands look into conservation. The Hands visit Kate Quinn and

ask if she is willing to wait to put the farm on the market while they look into the possibility of conserving the farm. Kate is delighted. She very much wishes to see her family’s farm continue in agriculture. However, she is also concerned that she will be a burden on her family if she does not get full value for her farm. The local land trust comes out to the farm to determine if it is going to be competitive for conservation funding, taking into consideration the soils, other important land features for commercial agriculture, the location, and the farm operation. In addition, the land trust reviews all the aspects of the easement and the process. Kate has to accept that the process might take well over

a year, but the Hands and Kate decide to proceed. After being approved as a pre-application at the VHCB Ag Advisory meeting, the Quinn Farm is appraised. The value of the conservation easement, which includes an Option to Purchase at Agricultural Value, comes in at \$305,000. At the closing, Kate Quinn ends up with her \$625,000 by selling the development rights on the farm to the land trust and selling the conserved farm to the Hands. Both sales are arranged as installment sales to mitigate some of the capital gains Kate will need to pay. Thanks to this arrangement, the Hands will find it much easier to cash flow the \$320,000 purchase price.



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Example 2:

A owns farmland with a total adjusted basis of \$100,000 and a fair market value of \$600,000. A sells a conservation easement on the property for \$200,000. Because the sale proceeds exceed A's basis in the property by \$100,000, A will apply \$100,000 against his basis leaving A with a zero basis in the property and A will recognize \$100,000 in gain.

Conservation and a Charitable Deduction

In cases where funding constraints do not allow a conservation organization to pay the full price for

an easement, landowners can realize some tax benefits by donating a portion of the value of the easement and claiming a charitable deduction. This is sometimes called a bargain sale.

When conservation is used to make farm transfer more affordable, the transaction can be structured as conservation followed by a sale to the successor or as a sale to the successor followed by conservation of the farm. Whether conservation precedes or follows the sale may well be a function of which party – the buyer or the seller – is in the best position to make use of a charitable deduction from a bargain sale. A taxpayer in a higher tax bracket and with higher income gains

the most from a charitable deduction.

Conservation by Installment Sales and Like-Kind Exchanges

Sellers may also spread out the recognition of gain on the sale of a conservation easement by using an installment sale. Additionally, a landowner may defer gain on the sale of a conservation easement by using a like-kind exchange. For example, a conservation easement may be exchanged for a fee interest in other farmland. For more on like-kind exchanges, see “Section 1031 Like-kind Exchanges” above.

Estate Planning

Estate planning is developing a plan for the disposition of real and personal property in anticipation of death. The goal of an estate plan may be to ensure the continuation of a family business or simply to distribute assets equitably among heirs. A primary objective may be to provide maintenance and support for a surviving spouse or minor or disabled child. An estate plan may also seek to shield as much family wealth as possible from taxation or to provide for charitable gifts to the organizations or causes important to the deceased.

Meeting some of the objectives of an estate plan may require a lifetime transfer of assets. Other

estate planning tools, such as Wills and Trusts, are designed to take effect after the death of the transferor.

Representing the “Family” in Estate and Farm Succession Planning

Attorneys and other service providers who counsel farm families about farm succession and family estate planning matters must clearly identify their client when they begin providing services. Is the client the owner of the property being transferred, the entity being formed, or the “family”? It's per-

missible for attorneys to represent multiple clients — several owners of a closely held business, a husband and wife, multiple trust beneficiaries, for example — only when multiple representation appears to be in the best interests of the clients. Where family members appear to have more common objectives than discordant ones, multiple representations can save them time and expense. However, if serious conflicts arise either at the outset or in the course of the work, it is best for each party to have separate counsel. These issues should be discussed openly with the clients and the outcome of that discussion should be included



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in the engagement letter. A multiple representation agreement will avoid any misunderstandings among the clients.

Attorneys and service providers also need to discuss the scope of information that may be shared among family members as well as with other service providers. Include consent to speak freely with other family members and with other service providers in the engagement letter or the case questionnaire that is signed by all the clients and returned to the attorney.

Intestacy — Dying without a Will

For those who die without a Will or Trust, the State of Vermont has a statute that dictates which kin receives what share of the property.⁴

- For those who die unmarried, their estate passes in equal shares to their children.
- For those who die married and without children, their surviving spouse may either take a third of

the estate or the whole of the estate if it does not exceed \$25,000. If it does exceed \$25,000, the surviving spouse is entitled to one-half of the remainder. The other half will pass as if the spouse had not survived. If there are no other kin, however, the surviving spouse will take the entire estate.

- For those who die without a surviving spouse and no children, the estate is divided in equal shares to the father and mother if they survive, or

What's in an Estate Plan?

An estate plan is a written document. It should be updated periodically and at a minimum, include the following:

- A Multigenerational Family Tree that includes social security numbers and contact information for each family member.
- An inventory of farm and non-farm assets and how each is titled.
- Farm and non-farm liabilities.
- A description of insurance policies that includes: ownership; name of the insured; face value; cash value; date of transfer, if any; and contact information.
- Retirement accounts including: IRAs, Roth IRAs, and any other retirement accounts.
- Location of important records including: will, trust, deeds, powers of attorney, durable power of attorney for health care, stock certificates, insurance policies, and partnership or other business operating agreements.
- Estimate of retirement needs including a retirement budget with housing, health, and living costs.
- Estimate of retirement income including: current estimate of social security benefits, IRA distributions, investment, rental, farm, or other income that will provide cash for retirement needs.
- Plan for succession of operating business including: assets to be transferred to respective heirs and method of transfer, such as buyouts or gifts; proposed schedule of transfer (by will/trust or annual gifting); summary of any buy-sell agreements; annual gifting plan; history of annual gifting.
- The plan for transfer of non-farm assets including non-farm real estate, stocks, bonds, and insurance proceeds.
- The plan for transfer of farm land.
- Wishes with respect to personal property.
- Budget for transition expenses: insurance premiums, professional fees, annual expenditures, periodic appraisals, and any other expenses.
- Names and addresses of personal representative/trustees.
- List of professional farm service providers, including: accountants, attorney, financial analyst, insurance agents, and brokerage firms.
- Charitable giving wishes.
- Attachments to the estate plan should include:
 - Copy of Will, Trust, Durable Power of Attorney, and Durable Power of Attorney for Health Care.
 - Gift tax returns.
 - Copy of business agreements including the operating agreement or partnership agreement.
 - Copies of deeds and other



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if one has predeceased, the whole will go to the surviving parent.

- For those who die without a spouse, children, or parents, the estate passes in equal shares to their brothers and sisters.

If none of the kin named above survive, the estate passes to the next of kin in equal degree.

- For those who die without any kin, their real and personal may “escheat,” or pass into public ownership. In this case, the personal property goes to the town in which the decedent lived. The real property escheats to the town in which the property is situated.⁵

Three Basic Estate Planning Documents

At a minimum, both the senior and junior generation members of the farm business should have the following three basic estate planning documents in place.

A Will

The purpose of a Will is to direct the distribution of assets at death. Without a Will, assets pass under a set of rules of descent devised by the state of Vermont, as described above.

A Will may direct the payment of last expenses, direct the transfer of specific assets to specific beneficiaries, and designate who shall receive the remainder of the estate.

It is especially important for families with young children to have a Will that names a guardian for their minor children should both parents die. A Will can also provide for the creation of a testamentary trust for the benefit of minor children and name a trustee to administer the trust for their benefit.

A Will also designates an executor or a personal representative who will carry out the wishes of the testator under the supervision of the probate court. A Will may also include instructions with respect to burial or funeral arrangements.

A Durable Power of Attorney

A Durable Power of Attorney allows a “principal” to designate an agent to act on their behalf should they become disabled or legally incompetent. A Durable Power of Attorney can ease the continuation of the farm business in the event of disability of one of the business principals. The agent’s power to act on the principal’s behalf may be effective on the day they both sign the power of attorney, or the agent’s powers may “spring” into being only when and if the principal becomes disabled or legally incompetent. This type of DPA is known as a springing power. A lawyer should draft a Durable Power of Attorney. Most DPAs grant the agent some very broad powers in a laundry list format. **For example, the agent is frequently empowered to:**

- Sign legally binding documents on the principal’s behalf;
- Do the principal’s banking;
- Manage real estate, including selling it;

- Collect rents;
- Sue or defend a suit;
- Collect debts owed to the principal;
- Access the principal’s safe deposit box;
- Manage the principal’s business;
- Deal with Social Security and other state and federal agencies on the principal’s behalf;
- Borrow money and pledge the principal’s property as security;
- Deal with the IRS and other taxing authorities;
- Make gifts to the principal’s spouse and children;
- Manage any stocks or bonds, including trading them;
- Hire, fire, and pay medical personnel and professional advisors; and
- Put the principal’s property into a revocable trust.

In the event of disability, a durable power of attorney will spare the principal’s family the trouble of going to court for a legal guardianship in order to manage his or her affairs. Where there is a durable power of attorney in place, the farm business can continue with minimal disruption. While a guardianship is court-supervised, the exercise of a power of attorney is not. **A principal should only choose someone whom they trust absolutely to be their agent.** If the principal doesn’t have someone like this, it may be best to have a court-supervised guardianship. A power of attorney can only be terminated by the principal’s death or by written notice.



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DPA for the Farm Business

In the farm context, a durable power of attorney should include the power to deal with those farm agencies, farm suppliers, and farm programs most likely to interact with the farm business. Your DPA should include, for example, the authority to make decisions regarding Vermont's current use program, farm creditors, the Vermont Agency of Agriculture, NRCS, and any other USDA program. It should also include the authority to conduct an appeal on the principals' behalf in the event of a denial of USDA program benefits.

Advance Directive for Health Care

An advance directive for health care is a document that gives to another the authority to make any and all health care decisions when the principal is not capable of making these decisions. The agent will have the authority to consent to life sustaining treatment, to withhold consent, or to withdraw life sustaining treatment. The Vermont Ethics Network has developed a new advance directive form available at: www.vtethicsnetwork.org.

The new advance directive form combines the purposes of the old Living Wills and Durable Power of Attorney for Health Care forms. The new form is also more comprehensive, covering organ donation and funeral direction issues. An attorney should assist a client in filling out this document whenever a Will or Trust is prepared.

Providing for Non-Farm Heirs

Farm families fortunate enough to have a succes-

sor to take over the operation often struggle to find strategies that are fair to non-farm heirs. Most families want to pass on a successful business while also maintaining close family relationships. Following are some ways that farm families have achieved a measure of comfort with differing bequests:

- They purchase life insurance for each heir. The farming heirs use the proceeds for estate taxes on the farm transfer or reinvestment in the farm while the non-farm heirs can use the proceeds any way they wish.
- They use life insurance to fund a buy-sell agreement that allows the farming heirs to purchase the farm from the parent's estate. Proceeds from the sale of the farm are distributed to all heirs.
- They leave parcels not necessary to the farming operation or those most amenable to development to non-farming heirs.
- They invest proceeds from the sale of development rights for the benefit of all the heirs.
- They leave all or a greater portion of non-farm assets to non-farming heirs.
- They place non-farm assets in a charitable remainder trust and use income from the trust to purchase replacement life insurance for the benefit of the non-farming heirs. (See the sidebar, "Charitable Remainder Trusts," on page 48 for an example.)

- They balance annual gifts of farm assets to farming heirs with gifts of cash to non-farming heirs.
- They give non-farm heirs a right of first refusal to purchase the farm at its agricultural use value. If the farm is ever sold for development, the non-farm heirs have the right to step in and purchase the property for its agricultural use value or otherwise share in the appreciated development value of the farm property.
- They leave the farm in trust for the benefit of those heirs actively farming. Under the terms of the trust, if the property is ever sold, all of the heirs will share in the proceeds.

The comfort level associated with any particular compromise will change as the estate changes. If over time, the farm assets appreciate faster than the assets going to the non-farm heirs, the family may have to revisit the issue.

An equitable estate plan doesn't simply allocate assets; it also allocates the unified credit and the tax burden associated with the transfer of assets. When bequests are not equal, it's important that estate taxes be "apportioned" so that each heir is responsible for the estate tax attributable to the assets he or she receives. Otherwise, liquid non-farm assets meant for non-farm heirs could go to pay the estate taxes due on the farm transfer. Most boiler plate tax allocation clauses have the taxes and expenses for administration coming out of the residue of



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the estate. If there are three heirs, and the farm is left to A with the residue of the estate going to B and C, under the standard tax allocation clause, A gets the farm and B and C will receive the residue less any estate taxes due. In this sense, the tax allocation clause is a dispositive provision. It's also important to ensure that

liabilities associated with farm assets transfer with the encumbrance.

Title to Personal and Real Property

How title is held to personal or real property can be a form of estate “planning” because a title af-

fects the disposition of the property upon death.

Tenants by the Entirety

In Vermont, married couples or couples in a civil union may hold title to real or personal property as “tenants by the entirety.” Each tenant is considered to own the whole; without the consent

Agents Owe Special Duties

Under the laws of the State of Vermont, designated agents have certain duties. First and foremost, they owe a “fiduciary duty” to their principal. A fiduciary duty requires that in the performance of their duties under this power of attorney, they always:

- Act in good faith and in the interest of the principal;
- Refrain from self-dealing or in their own self interest and benefit;
- Avoid conflicts of interest which would impair their ability to act in the best interests of the principal;
- Do not commingle the funds of the principal with their own funds or the funds of third parties;
- Exercise the degree of care that would be observed by a prudent person dealing with the property and affairs of another person;

- Take no action beyond the scope of authority granted by the terms of the power of attorney;
- Keep records of all transactions taken under the power of attorney;
- Provide accountings upon request of the principal or at such times or in such manner as is specified by the terms of the power of attorney;
- Always follow the directions of the principal specifically forbidding an action, notwithstanding any provision of the power of attorney giving the authority to take such action; and
- Comply with any lawful termination of the power of attorney upon notice of the principal.

Vermont law also puts some limits on the powers of an Agent under a power of attorney:

- The agent may not exceed the authority given under the power of attorney.
- The agent may not use it to make health care decisions or to change or revoke the principal's durable power of attorney for health care or his/her living will.
- The agent may not use it to change or revoke the principal's will.
- The agent may not require the principal to take any action against his or her will.
- The agent may not use the power of attorney to act as a personal representative or a trustee on the principal's behalf unless the trust specifically authorizes it.
- The agent may not take any action specifically forbidden by the principal.
- The agent may not convey lands belonging to the principal unless the

power of attorney is properly executed and the power of attorney specifically provides for that authority.

- The agent may not compensate him or herself for duties performed under the power of attorney unless the power of attorney specifically provides for compensation.

The agent may not make a loan or a gift of the principal's property to others or to him or herself unless the power of attorney specifically provides for gifts.

- The agent may not appoint another person to act as an alternate or successor agent unless the power of attorney specifically provides that authority.

A power of attorney may not limit or waive a principal's right to an accounting.



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of the other, neither has the power to convey the property to a third person or pledge it as security for a personal debt. The principal difference between tenancy by the entirety and joint tenancy is the inability to encumber the property without the consent of the other tenant. Creditors of only one spouse are unable to attach the property unless the debt was incurred for the necessary upkeep of the property.⁶ In this way, a tenancy by the entirety provides a kind of liability shield. Unless the deed or other title document indicates otherwise, at the death of one spouse, the surviving tenant by the entirety automatically becomes the full owner of the property. If the couple is divorced, the tenancy by the entirety is terminated and ownership becomes a tenancy in common.

Tenancy in Common

Any transfer of land to two or more people is presumed to create a “tenancy in common.”⁷ In a tenancy in common, each owner owns an undivided interest in the whole. If there are two tenants in common, each is said to own a “one-half undivided interest” in the property. Tenants in common may own equal or unequal “undivided” interests. Upon the death of one tenant in common, his or her interest passes to his heirs under the terms of his will or under the laws of intestacy, if he has no will. He may leave his interest to any heir or heirs he wishes. If the Will provides that his heirs are to take equal shares of the estate, they will take their respective fractional share of the property. For example, if a one-half undivided interest passes to

four heirs in equal share, they will each take a one eighth undivided interest in the whole.

Joint Tenancy

To create a joint tenancy in real or personal property, the deed or other title document must clearly express intent to create a joint tenancy. A joint tenancy is created by using words such as “with rights of survivorship,” or “WROS,” or “as joint tenants and not tenants in common” in the title document. If there is any ambiguity in the deed, courts will resolve the question in favor of a tenancy in common. Whether you own an interest as a joint tenant or a tenant in common makes a big difference. Upon the death of a joint tenant, the property passes to the survivor. If the farm is titled in the name of two farm partners “as joint tenants with rights of survivorship,” the whole title to the farm passes to the other partner upon the death of one partner. Title passes automatically without going through probate or passing under the joint tenant’s will. Upon the death of a tenant in common, on the other hand, that person’s interest is passed to his or her heirs under a Will or under the laws of intestacy.

At common law, joint tenants could only own equal shares of joint tenancy property. A recent change made by the Vermont legislature allows joint tenants to own equal or non-equal interests in joint tenancy property.⁸ If the title document is silent, equal ownership is presumed. Where a fractional share is expressed and a joint tenant dies, his or her share will be allocated among the survivors

in proportion to their respective joint interests at the time of the joint tenant’s death. For example, if there are three joint tenants and A owns 50 percent, B owns 25 percent, and C owns 25 percent, and A dies, B and C will each take a proportional share of A’s 50% interest. Each will now own 50% of the property. If B dies, A’s proportional share will be $\frac{2}{3}$ of B’s interest, and C’s proportional share will be $\frac{1}{3}$ of B’s interest, leaving them with a $\frac{66}{100}$ and $\frac{2}{3}$ interest and a $\frac{33}{100}$ and $\frac{1}{3}$ interest respectively.

A Life Estate

A life estate is an interest in land that endures for the life of the life tenant. Where there is a life estate, there must also be a “remainder interest” in the property that will pass to whomever is to take the property at the death of the life tenant.

Leaving a life estate to a spouse and the remainder interest to your children is a traditional estate planning technique designed to provide for one’s spouse after death while ensuring that the property ultimately ends up with children of the marriage rather than with a new spouse or the children of a successive marriage. The same objectives are more appropriately accomplished through the use of revocable living trusts, which will be discussed later in this chapter.

At the death of the life tenant, the property passes automatically to the “remaindermen.” The remainder interest passes automatically. It does not go through probate or pass under the terms of a Will.



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Probate and Non-Probate Assets

Probate is a court-supervised process for proving a Will and carrying out its provisions. An executor prepares an inventory of the decedent's estate, notifies and pays creditors and other claimants, and otherwise carries out the instructions found in the Will. Heirs and others named in the Will are notified and kept informed about the process.

The assets that pass by virtue of a Will and must therefore go through probate are called probate assets. However, some assets, such as

property held in joint tenancy, automatically pass to the surviving joint tenant upon the death of a joint tenant. These assets do not pass as a result of a Will, but by law. This asset needn't go through probate. Other non-probate assets include IRA's, annuities, insurance policies, and any other specialized assets for which the deceased has designated a named "beneficiary." These assets also pass automatically upon the death of the insured. Assets in a revocable living trust, as described later in this chapter, also avoid the probate process. All the assets must be specifically titled to a trust, however.

Basis at Transfer — The "Stepped Up" Basis

Whenever property is transferred, it is important to track what happens to the asset's "basis." Generally, your "basis" in property is what you paid for it. If you later sell the property you may have to pay a capital gain tax on the difference between the selling price and your basis.

When you give property away during your lifetime, the person to whom you give it gets a "carryover basis," meaning that your basis will

The Charitable Remainder Trust

Charitable Remainder Trusts are most useful for estates that will be subject to the estate tax, for high income donors who can benefit from a charitable deduction, and for property that would result in significant capital gain if it were sold and re-invested.

A CRT is an irrevocable trust. The donor places property into the trust, giving up all rights to the trust property but retaining an income interest. At the donor's death, the trust property passes to a charity of the donor's choosing. The donor is allowed to take a charitable deduction when the property is placed in the trust. How

much of a charitable deduction is based on an IRS formula that takes into account the income beneficiary's age, the value of the property donated, the income that will be withdrawn over the life of the Trust and other factors. The amount a donor can deduct in any given year may be limited, however; for gifts of appreciated property, for example, the donor can only deduct 30 percent of his or her adjusted gross income. The donor can deduct the balance in future years.

The donor's income interest can be a fixed percentage – at least 5 percent – or a fixed amount to be

paid each year. The donor may also designate someone else as the income beneficiary. The income can be paid for a term of years or can be paid until the income beneficiary's death. The CRT allows the donor to take the asset out of the taxable estate while retaining the income from the property.

The property in the CRT will be managed by a trustee. The property donated can be securities, cash, or land. The Trustee can be the charity, a bank trust department, or the donor. If the property is highly appreciated or a low income-producing asset, the Trustee can sell the asset and

reinvest it in a high income-producing asset. The donor can thus sell and reinvest assets and increase his or her income without having to recognize the capital gain that would result from selling it as an individual.

Income from the CRT can also be used to fund replacement life insurance. The donor can make annual gifts to heirs from the CRT income that is used to purchase life insurance on the life of the donor. The policy is owned by the heirs or by an irrevocable insurance trust and is not taxed in the donor's estate at the donor's death. The life insurance thus replaces the asset donated to charity.



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carry over to the new owner. If you made a lifetime gift of farmland with a basis of \$10,000 to a successor, the successor's basis in the property is \$10,000.

For property that passes at your death, however, there is another rule for basis. For these transfers, the heir receives a "stepped up" basis. The basis for the heir becomes the fair market value of the asset on the date of death. A remainder interest that passes automatically at the conclusion of a life estate also gets a step up in basis equal to the fair market value of the property on the date of death of the holder of the life estate.

These rules on basis have a tremendous impact on the timing of a transfer of farm assets, particularly land. If the senior generation purchased the farm in the 1950s, its value has probably appreciated significantly. A lifetime transfer will give the heirs a very low basis. A transfer at death will result in a much higher basis. Heirs, especially farming heirs, need to understand the long term tax consequences of a lifetime transfer of low basis farm assets. Both generations need to weigh the capital gain consequences with many other factors such as estate tax liability. If the asset is appreciating rapidly and it appears that the estate will be subject to an estate tax, it may be best to begin moving the farmland out of the estate and into the hands of heirs no matter what the basis. In addition, sometimes business, family, or personal reasons argue for a lifetime transfer of farm assets.

Revocable Living Trusts

More complex estates require more complex estate planning tools. An "inter vivos" or "living trust," so-called because it is created during the lifetime of the creator of the trust, can offer valuable estate planning and asset management tools. It can provide significant estate tax benefits and provide for the continuing management and transfer of an ongoing farm business even after the death of its creator. A trust can also provide income and other support benefits to a surviving spouse while ensuring that at the second spouse's death the asset will go to the heirs of the creator of the trust — not to someone else's heirs. All of these aspects of a revocable living trust will be discussed in turn.

Revocable living trusts, however, are not for everyone. They are a sophisticated estate planning tool that requires a higher level of effort on the part of the creator of the trust to set up as well as from those who administer the trust after his or her death. Using a trust successfully requires a considerable investment of time and effort.

Basic Trust Mechanics

A living trust is created by a trust agreement. At a minimum, the trust agreement will create a trust and provide for its initial funding. The trust agreement will also dictate the powers of the trustee over the trust property and designate a successor trustee. It will provide for revocation or amendment during the creator's lifetime and

for the use of trust assets in the event the creator becomes disabled. The trust agreement will also, much like a Will, specify the trust beneficiaries and the disposition of trust assets at the death of the creator of the trust.

The creator of the trust is called the "settlor." The settlor may, and most often does, act as the initial trustee of his or her own trust. As the initial trustee, the settlor continues to manage, control, and take the income from all of the assets placed in the trust. The broad powers of the Trustee in the trust agreement usually allow the mortgage, sale, or other acts of "dominion" over the assets. Assets may also be removed from the trust. In a living trust, the trust is "revocable" until the death of the grantor, meaning that assets can be removed from the trust and the trust may be amended or completely revoked. While the trust is revocable, it is a "grantor trust" and is considered a "disregarded entity" by the IRS, meaning that the settlor continues to claim income from the trust assets on his or her personal tax return. While the trust is revocable, it does not need a tax identification number or to file its own tax return.

The initial transfer of property into a revocable living trust is not considered a taxable transfer and will not result in capital gain or a change in tax basis. A transfer of real estate into the trust is also exempt from the Vermont property transfer tax.⁹

Creating a trust can be expensive. If the trust involves complex estate tax issues, you can expect a fee of \$1,500 to \$2,000. Along with the fee for



drafting the trust agreement, there will also be the expense of re-titling property to the trust. You must re-title all assets including checking and savings accounts, brokerage accounts, and other assets. Re-titling stock certificates can be particularly time consuming. Depending on the goals of the trust, jointly held property may also have to be re-titled. Where both spouses, for example, own property as tenants by the entireties, the property will be re-titled as a one-half undivided interest in each spouse's trust. Interests in a partnership or limited liability company must also be assigned to the trust. IRAs, on the other hand, are not re-titled to the trust.

Special care must be taken in transferring title of farm and non-farm assets to a trust. Creditors with liens on the property will need to be informed, and in the case of real estate, a new application for special use valuation must be submitted. In most instances, a transfer will not trigger a land use change tax under Vermont's Current Use Program (Current Use). For as long as the trust continues to meet the statutory definition of a "farmer," the trust should continue qualify for the program, although a new application will need to be filed to reflect the new owner.¹⁰ To meet the definition of a farmer, one-half of the annual gross income must be derived from the business of farming or the land must be leased to a farmer.

Putting a home in a revocable living trust can also have Medicaid eligibility consequences. Homes in revocable living trusts are not excluded for Medicaid eligibility purposes in Vermont. Homeowners who need to establish eligibility for

“Creating a trust can be expensive. If the trust involves complex estate tax issues, you can expect a fee of \$1,500 to \$2,000.

Medicaid may remove the home from the trust and the home will again be considered an excluded resource. (See “Transfers of Property to a Trust” in the Medicaid Section on page 63.)

There is no case law directly on point in Vermont on whether placing a home into a revocable living trust would result in the loss of the homestead exemption. The Vermont homestead exemption protects up to \$75,000 in equity in a personal residence from the claims of unsecured creditors.¹¹ In most states, placing a home in a revocable living trust will not cost the settlor the value of the homestead exemption.

At the death of the settlor, the trust becomes irrevocable and a successor trustee named by the trust agreement takes over the duties of the trustee. A successor trustee may be a spouse or other family member or an institution such as a bank. The successor trustee may also take over the management of trust assets in the event the settlor becomes disabled. Should the settlor become disabled, the trust agreement will ordinarily provide that income from the trust assets can be used for the settlor's care and support. A trust spares the family the necessity of going to court to establish a guardianship to manage the assets of the disabled family member.

At the death of the grantor, the trust assets will receive a step up in basis. The tax basis will be the fair market value of the assets on the date of the settlor's death. There is also an alternative valuation option under the federal estate tax code. Because valuation can fluctuate widely for some assets, the code allows a decedent to value the estate at its fair market value on the date of death or six



months after the date of death. A significant rise in the value of the assets and choosing the alternative valuation date would provide a higher tax basis in the hands of the heir.

Assuming that all of the Grantor's assets were placed in the trust, at the death of the settlor the estate does not have to go through the probate process. However, probate assets not in the trust will still have to go through probate. Avoiding probate is one of the frequent "selling points" for revocable living trusts. Probate is a court-supervised process for proving and settling a decedent's estate. In states such as Vermont, where the probate process is, relatively speaking, orderly and efficient, this may not be such a big advantage. And some families can benefit from the probate process. Estates that involve family dissension or distrust, for example, can benefit from court supervision.

A trust will at least avoid the expense of probate, which can be considerable for a complex estate. The costs of a trust will be born "up front" at the time the trust agreement is first drafted. There will also be fees if the trust agreement is amended. After the settlor's death, there are costs associated with trust administration. A trust, however, will also keep the trust's administration largely private because the trust agreement will never be a public document. Probate files and the Wills probated within them are open to the public.

After the Settlor's Death

At the settlor's death, the trust becomes irrevocable. The successor trustee steps in to administer the trust

assets and to carry out the settlor's intent with respect to the disposition of the trust assets. The trust agreement will direct the successor trustee to pay any estate taxes, funeral expenses, and other debts of the decedent. The trust agreement may direct the disposition of specific assets outright to particular beneficiary or continue to hold assets in trust until the beneficiary reaches a certain age. The trust agreement may also provide for the funding of one or several "subtrusts" at the death of the settler – a marital trust or family trust, for example.

These subtrusts are separate entities that require their own tax identification numbers and their own tax returns. They must be managed as separate entities, without co-mingling of other funds, and there are fiduciary duties owed by the trustee to the beneficiaries of the trusts.

Avoiding Estate Taxation at the First Death

Assets which pass outright to a surviving spouse will qualify for the unlimited "marital deduction" for estate tax purposes. The marital deduction allows couples to avoid estate taxation upon the first spouse's death. Property that passes into the estate of the surviving spouse will be taxed in the surviving spouse's estate, thus deferring estate tax liability until the second death. For example, H leaves his entire estate of 4 million dollars to W. No tax will be due upon H's death, but when W passes away, W's estate will be liable for the estate tax due that may be due on the 4 million left by W plus any other assets in W's estate.

The tax code also allows a marital deduction for property placed in certain qualifying marital trusts which allow the grantor to direct the disposition of the property after the death of the surviving spouse. These trusts, which provide income and support to the surviving spouse, are sometimes called QTIP trusts. To qualify as a QTIP, the surviving spouse must have rights to all the income from the trust property and also be the sole beneficiary of the trust during the spouse's lifetime. At the surviving spouse's death, however, the trust may direct that the remainder of trust assets be distributed to heirs of the settlor's choosing rather than the choice of the surviving spouse. For example, H leaves 2 million dollars in a QTIP Marital Trust for the benefit of W. During W's lifetime, the trustee distributes all the income earned from the trust property to W. At W's death, as H directed, the remainder of the estate passes to their daughter, D. The property that passes at W's death is taxed in W's estate.

Other types of marital trusts also qualify for the unlimited marital deduction, and some allow distributions from the Marital Trust to other family members during the surviving spouse's lifetime. The QTIP trust is just one example of a trust that will qualify for the marital deduction.

Minimizing Estate Taxes at the Second Death

In the examples above, the marital deduction was effective in deferring the estate tax until the second



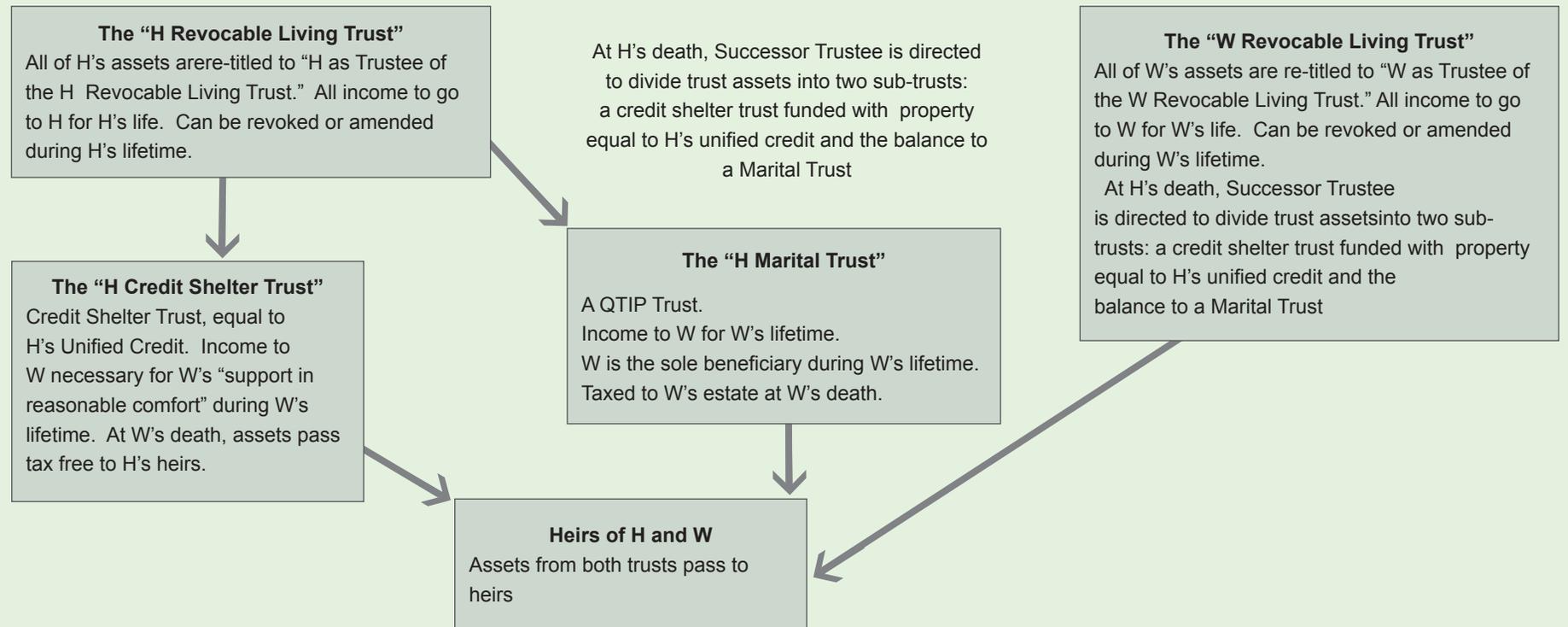
death. Additional estate tax savings are available through the use of a credit shelter trust, sometimes called a By-pass Trust, Non-marital Trust or a Family Trust. Credit shelter trust property does not pass to the surviving spouse but instead, “by-passes” the surviving spouse’s estate. It can be funded in an amount equal to the federal estate tax exclusion amount that is applicable on the date of the first

spouse’s death or on the basis of some other formula that divides the estate between a Marital Trust and a Credit Shelter Trust. The income and principal from the Credit Shelter Trust may be used to support the surviving spouse to an “ascertainable standard.” The Trust may direct the trustee to make distributions for the surviving spouse’s “health, education, maintenance and support”, for example.

The Credit Shelter Trust may also provide for the needs of other family members.

The surviving spouse may not direct the disposition of any of the assets in the Credit Shelter Trust or risk having the property included in his or her estate. At the surviving spouse’s death, the assets and any appreciation in the value of the assets may be distributed to their heirs free of the estate tax.

Revocable Living Trust – Example





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For example, H dies with an estate of 4 million dollars. His trust directs that an amount equal to the exclusion amount applicable on the date of his death, in this case \$2 million, be placed in a Credit Shelter Trust and the balance to be placed in a Marital Trust. The Marital Trust directs the distribution of income solely to the surviving spouse during her lifetime. The Credit Shelter Trust directs the trustee to provide income and principal necessary for W's "health, education, maintenance and support." At W's death, the trustee is directed to distribute the property in both the Marital and the Credit Shelter Trusts to D. The Credit Shelter Trust, including

any appreciated value since the death of H, passes to D, free of the estate tax, at W's death. The assets in the Marital Trust will be sheltered from the estate tax by using W's unified credit.

Utilizing both the marital deduction and a Credit Shelter Trust allows couples to make full use of the exclusion amount available to each of them. In the last example, both H and W would be able to exclude \$2 million from their respective estates. If H died leaving all of his estate in a Marital Trust or outright to his spouse to be taxed at the surviving spouse's death, his estate tax exclusion would be lost.

Planning for the use of both the marital deduction

and the Credit Shelter Trust can be accomplished through a Revocable Living Trust or through a testamentary transfer at death. A testamentary transfer of assets of the estate into the respective trusts would be directed in both H and W's Wills. Unlike a Revocable Living Trust, a testamentary transfer would require that the estate be probated. But it would not require a lifetime transfer of all of H and W's assets into a Revocable Living Trust. In states like Vermont, where probate is comparatively speaking, less onerous, a testamentary transfer may offer the simplest approach to planning for the use of both the marital deduction and the Credit Shelter Trust.



Estate Taxes

The purpose of our federal estate tax is to discourage the concentration of wealth in the hands of a few.¹² A secondary purpose has been to encourage the productive contribution to society of all our citizens by making it difficult for some to rely principally on inherited wealth for their livelihood. The estate tax has also been justified as a reasonable imposition for the privilege of conducting business in a capitalist society.

The estate tax affects a truly small number of tax payers. In 2003, of the roughly 2.3 million deaths, only 30,627 incurred any estate tax liability.¹³ In Vermont, just 87 estates paid some estate tax in 2003. In 2003, only those estates in excess of \$1 million were at all likely to face an estate tax.

The number of farm estates subject to the estate tax is even smaller. Of the 30,627 taxable estates nationwide in 2003, it is estimated that just 1,967 reported some farm property, most of it held by estates worth in excess of \$10 million.¹⁴

There are a number of reasons why farm estates are unlikely to pay an estate tax. For one thing, the farm economy did not participate in the boom of the 1990s at levels proportionate with the non-farm sector. In addition, Congress has provided numerous mechanisms for farm and other small business estates to minimize the estate tax burden. Good planning and the use of the revocable living trust can ensure that both spouses take full advantage of the estate tax exclusion. Special use valuation and

other tax benefits available only for farms have allowed many farm families to pass on farm assets to farming heirs without incurring an estate tax.

Tax reform efforts that gradually increase the size of estates subject to taxation and an outright repeal of the estate tax will also mean that fewer farm estates will face tax liability. It is estimated that the primary beneficiaries of estate tax reform will be the heirs of the wealthiest 2 percent of decedents with taxable estates above \$5 million.¹⁵

Under our federal estate tax system, each individual is allowed a cumulative credit for transfers of wealth during their lifetime and at their death variously called the “exclusion amount” or the “unified credit.” Because each individual has a unified credit, couples can pass estates with a value of twice their unified credit – estate tax free – to their heirs. The unified credit is currently at \$2,000,000. There is, however, a lifetime limit on gifts of \$1,000,000.

As a result of an estate tax relief measure passed in 2001, the Economic Growth and Tax Relief Reconciliation Act (EGTRRA), estate taxes are being gradually phased out. The Act gradually raises the unified credit, reduces tax rates, and repeals the estate tax entirely in 2009. The chart below details the increases in the unified credit and the year of repeal.

Because the legislation repealing the estate tax will expire in 2010, the law will revert to the es-

tate tax laws in place in 2001, if there is no further legislation. In 2001, the unified credit was \$1,000,000.

As a means of paying for the one-year repeal of the estate tax in 2010, Congress eliminated the step up in basis for heirs. Instead of a step up in basis, heirs will take a carry over basis. Congress did include some very complicated rules allowing some heirs to increase their basis by as much as \$1,300,000. In the case of a qualifying spouse, an additional \$3,000,000 may be added to basis. These rules apply only to deaths in the year 2010.

There is much concern that a permanent repeal of the estate tax will result in a permanent repeal of the step up in basis. A repeal of the step up in basis rule could have a disproportionately onerous impact on farmers.

The gradual nature of the estate tax repeal coupled with the uncertainty with respect to the basis rules and further legislation to extend or repeal the estate tax can make estate planning very difficult. It's essential to periodically review your estate plan to keep pace with changes in the law.

Annual Gifting

The “unified” nature of the unified credit used to mean that gifts made during a person's lifetime counted against the individual's overall unified credit. Under EGTRRA, however, the gift tax was



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decoupled from the estate tax. There is now a lifetime limit on gifts of \$1,000,000 even though the unified credit is \$2,000,000.

There is also an “annual exclusion” from the estate tax for lifetime gifts that do not exceed an annual exclusion amount. In the year 2006, gifts of up to \$12,000 are excluded for the purposes of determining the gift tax. The annual exclusion amount is pegged to the rate of inflation, so it is likely to increase periodically. Over time, annual gifting can reduce an estate to levels below the threshold of estate taxation, effectively passing wealth to heirs on a tax-free basis.

Married couples may make so-called “split gifts,”

meaning that one spouse can make a gift of property with a value of \$24,000 if the other spouse consents. This has the effect of doubling the annual exclusion amount.

Mechanisms for Reducing the Estate Tax

Special Use Valuation¹⁶

Special use valuation can substantially reduce estate tax liability, especially where development pressures are driving farmland values upwards. Section 2032A allows certain farm estates to value farmland at its agricultural use value rather than its

fair market value.

For decedents dying in 2006, the aggregate decrease allowed under Section 2032A may not exceed \$900,000. This limitation is indexed for inflation, so it’s likely to increase regularly.

Qualified Real Property

To qualify, the property must be located in the U.S. and it must be acquired by or passed down to a “qualified heir” for use as a farm. A qualified heir includes an ancestor, a lineal descendent, a spouse, or a spouse of a lineal descendent.

The farm business assets – both real estate and personal assets such as equipment and livestock – that are passing to a qualified heir must make up at least 50 percent of the adjusted gross estate. The farmland must account for at least 25 percent of the adjusted gross estate owned by the family.¹⁷ The adjusted value is the property’s fair market value rather than its special use valuation, less any debt against the property.

For five out of the last eight years, the property must have been owned by the decedent, have been used for farming, and the decedent or a member of his or her family must have “materially participated” in the farming operation. Generally speaking, material participation means being actively involved in the day-to-day labor and management of the farm. There are, however, some special rules for surviving spouses that treat active management as material participation.

Within ten years of the decedent’s death, the estate tax savings from special use valuation are sub-

Unified Credit

Year of Death	Unified Credit	Maximum Tax Rate
2005	\$1,500,000	47%
2006 - 2008	\$2,000,000	46% in 2006 45% in 2007-08
2009	\$3,500,000	45%
2010	Estate tax is repealed	
2011	Without further legislation, the unified credit will revert back to its level in 2001, which was \$1,000,000	55%



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ject to recapture if: any interest in the property is disposed of outside the family, the property ceases to be used for farming, or the qualified heir fails to materially participate for three out of eight years in any eight-year period. However, selling or donating a conservation easement is **not** considered a disposition that triggers the recapture of estate taxes.¹⁸

The following formula is used to determine the property's agricultural use value:

(Capitalization of comparable rent – capitalization of income stream) / interest rate.

To calculate this, take the average annual gross cash rental for comparable farm land in the area less the average annual real estate taxes and divide by the average annual effective interest rates for all new Federal Land Bank Loans.

As an example, assume 200 acres of farmland with a fair market value of \$500,000 and real estate taxes of \$8,000. The average annual effective interest rate for federal land bank loans applicable for Vermont for 2004 was 6.64 percent.¹⁹ Assuming a comparable rent of \$75 an acre, or \$15,000, figure \$15,000 (annual cash rent) less \$8,000 (real estate taxes) = \$7,000 divided by 6.64% (FLB interest rate) = \$105,422. That is the agricultural use value. In this example, using the agricultural use value would reduce the gross estate by \$394,578.

Aside from the risk of recapture in the event of farm failure or other circumstances beyond the qualified heir's control, special use valuation will also affect the property's basis. Rather than a stepped up basis, the heir will take a basis equal

to the special use valuation.

Discounted Valuation for a Minority Interest and Lack of Marketability.

Some taxpayers have realized significant estate tax savings by claiming a discounted valuation on business interests gifted during their lifetime or left to heirs by Will or Trust. The value of a fractional interest in a farm operation or farmland in an LLC or family partnership isn't the same as the value of a proportionate share of the underlying farm asset. For assets held in an entity, an LLC, for example, rights in the assets are governed by an operating agreement. The operating agreement may allocate control of the asset to the majority share holders, or an economic interest in the business may have not voting rights at all. The operating agreement may also restrict a shareholder's rights to transfer the property outside the family or impose other restrictions on marketability. When the LLC shares owned by the transferor represent a minority and non-controlling interest and when there is little market for the shares outside the family, the IRS has recognized a discounted value of 20 to 40 percent. If all the assets of the business taken together have a value of \$100,000, for example, a 10% interest discounted by 40 percent would be worth \$6,000 rather than \$10,000. Whenever a discount is used to value gifted property, it must be reported on the gift tax return and documented further with a discount appraisal.

The IRS has begun to successfully challenge minority interest and lack of marketability discounts in certain cases.²⁰ Transfers made within 3 years

before the taxpayer's death are vulnerable to IRS challenge. Where the IRS has been successful, the discount has been lost and the gifted property has been included back in the donor's estate. Successful challenges have involved taxpayers who placed assets in an entity but continued to enjoy the primary benefit of the assets. Factors that made the transfer vulnerable to IRS scrutiny included: a failure to observe the formalities required by the business agreement, distributions tied to meeting the donor's personal living expenses, and putting virtually all of the donor's assets into the entity without reserving adequate assets for his or her personal support. The IRS looks for factors suggesting an implied agreement that the donor will continue to enjoy all the benefits of the property during his or her lifetime in the same manner as before the entity was created. Commingling of funds or continuing to use entity property without payment of rent, for example, all suggest an implied agreement.

Courts have allowed a discount and recognized a transfer as legitimate where there was a substantial and legitimate business purpose for placing the assets into an entity.²¹ Gifts of an interest in an ongoing farming operation should fare well under this type of analysis where there is an ongoing family enterprise for profit and the gifts are made only to heirs actively involved in the farm business. Gifts of farmland to the farming heirs in the form of LLC units, however, may be vulnerable unless there are regular distributions under the terms of a business agreement and a fair market value rental is paid by the farm operation.



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The IRS has also challenged transfers of business interests where at the time of death the donor retained the right to determine distributions of income or controlled the timing of dissolution and liquidation of the company.²² In these cases, the IRS has argued that all the transferred shares should be pulled back into the donor's estate. The IRS position has been much criticized and the case law on this issue is complex and still evolving. Until resolved, business agreements should be structured to avoid IRS scrutiny. Agreements that hold a donor's decisions regarding distributions to a clear standard enforceable by a court of law or that otherwise restrict the donor's rights to designate who will receive distributions or liquidation rights should avoid IRS scrutiny. Transferring all controlling interests out of the donor's estate will most certainly avoid this problem.

Conservation Easements

Selling or donating a conservation easement can provide significant estate tax benefits. Farmland subject to a conservation easement is valued for estate tax purposes at its conserved value, which in most cases will be considerably less than its fair market value with full development rights. A farmland conservation easement that includes an option to purchase at agricultural value can provide a further reduction in value for estate tax purposes. (See "Easements with an Option to Purchase at Agricultural Value," page 40.)

Donating a qualified conservation easement can yield a further exclusion from the estate and a sig-

nificant reduction in the estate tax. The donation can occur even after death if the donor makes an election on the estate tax return. For donations of easements that reduce the property's value by at least 30 percent, the donor and his descendants may exclude 40 percent of the remaining value of the property from the gross estate. For example, if the property has a fair market value of \$500,000 and the easement reduces the value of the property to \$300,000, the estate could exclude \$120,000 (40% of \$300,000) of the property's value from the gross estate. The overall exclusion, however, is limited to \$500,000.²³ For a more detailed description of this provision prepared by the Vermont Land Trust, see: http://www.vlt.org/Tax_Benefits_Donating_Easements.pdf.

Estate Taxes on the Installment Plan

Farmers and other owners of closely held family businesses may be able to pay their federal estate taxes in installments of at least two, but not more than ten, annual payments.²⁴ They may also defer the initial payment of principal for up to five years, providing for a fifteen-year repayment period. To be eligible, the value of the farm business assets must exceed 35 percent of the adjusted gross estate. For example, if the farm is worth \$1,000,000, the gross estate may not exceed \$2,857,143. You may defer a portion of the tax liability that bears the same ratio to the tax due as the value of the farm bears to the value of the adjusted gross estate. For example, if the farm assets make up 40 percent of the estate,

you may defer 40 percent of the estate tax liability.

The value of a farm home and related improvements and homes occupied by farm employees may be counted toward the 35 percent requirement.²⁵

Principal payments may be deferred for up to five years, although interest on the unpaid tax must be made annually during the deferral period. After the deferral period, interest payments are made along with annual principal payments. If there is a sale or other disposition of more than 50 percent of the business, the time extension will be withdrawn and the tax will be immediately due and payable.²⁶

For deaths in 2004, the interest rate on the first \$532,000 of estate tax due was subject to a 2 percent interest rate. Interest on the portion in excess of \$532,000 was subject to an interest rate set at 45 percent of the IRS rate for underpayment of taxes, which is announced quarterly by the IRS and is currently set at 6 percent. (The amount subject to a 2 percent interest rate is indexed for inflation, so deaths in later years may enjoy a higher threshold.)

The Vermont Estate and Gift Tax

Vermont does not have a gift tax. Vermont does, however, have an estate tax. For many years Vermont imposed an estate tax equal to the maximum state death tax credit allowed under the federal income tax. The appropriate state credit for federal estate tax purposes was determined using a graduated rate table for the size of the estate. Tying the Vermont estate tax to the allowable federal credit had the effect of bringing in revenue to the state without adding to an individual's estate tax liability because the state just picked up an



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amount equal to the state credit. Many states were using this “pick up” tax prior to the federal tax reform legislation in 2001.

In 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) amended the federal tax code to gradually repeal the state death tax credit between years 2002 and 2005. The credit was gradually phased out and replaced with a deduction for state death taxes. To address the potential loss in revenue, Vermont amended its tax code. Under the new law, for decedent’s dying after January 1, 2002, the Vermont estate tax is equal to the amount of the estate tax death tax credit allowed under federal law in effect on January 1, 2001, before the passage of EGTRRA. By tying the state’s estate tax to the former credit amount, Vermont was able to make up at least some of the lost revenue resulting from tax reform. More changes may be in store if there are further changes to the federal estate tax.

Vermont provides an Estate Tax Worksheet with the E-1 Vermont Estate Tax Return. The worksheet provides a table for calculating the Vermont estate tax liability as pegged to the pre EGTRRA law. The table uses the taxpayer’s federal taxable estate – roughly the gross estate less any applicable federal exclusions or credits – less an adjustment of \$60,000. For decedent’s dying after December 31, 2004, with a federal adjusted taxable estate of \$1,540,000, for example, the Vermont estate tax was \$70,800. The worksheet is available at: <http://www.state.vt.us/tax/pdf.word.excel/forms/2005/e-1.pdf>.

In 2001, the Vermont legislature also passed an estate tax reduction for some farm estates.²⁷ Farms that are eligible to pay their federal estate taxes in installments under 26 U.S.C. §6166 described above may reduce their Vermont estate taxes significantly. The reduction is equal to the percentage that the value of the closely held farm business, as determined for federal estate tax purposes, bears to the value of the federal adjusted gross estate. If the farm business makes up 50 percent of the federal adjusted gross estate, the Vermont estate tax will be reduced by 50 percent.

The Generation Skipping Tax

Farm families passing significant assets to grandchildren should take the Generation Skipping Tax, or GST, into account when they plan. The GST is paid in addition to the estate tax. The law limits the amount any one individual can pass to his or her grandchildren free of taxation. The GST exemption for 2006 is \$2,000,000. The exemption will gradually increase through tax year 2009 to \$3,500,000 and, like the estate tax, will have a one-year repeal in 2010. In 2011 it will snap back to \$1,060,000. The purpose of the GST is to discourage wealthy families from transferring large sums of money directly to the third generation – in effect skipping a generation and avoiding one step of taxation. If significant assets are going to grandchildren, a Generation Skipping Trust limited to the available GST exclusion will ensure the full use of the GST exemption.

“Farm families passing significant assets to grandchildren should take the Generation Skipping Tax or GST, into account when they plan.”



Farm Transfer and Medicaid Planning

Medicaid is a joint federal and state poverty program that covers the costs of long-term nursing home level care for individuals who meet certain income and resource limits and who fit certain categorical eligibility requirements. The Medicaid rules governing allowable and available assets, income, and property transfers are complex. The rules are intended to reduce the costs to the public of providing long-term care by ensuring that resources available to the institutionalized family member are used before public support is utilized.²⁸

Many families plan ahead to preserve estate assets in the event that long-term care is necessary. They may convert assets considered available under the Medicaid rules to assets considered not available. In some cases, assets may be transferred to other family members outside the “responsibility group,” i.e., to those not financially responsible for the institutionalized family member. Post-death planning is also possible because in some cases, the Medicaid program seeks to recover its expenditures for long-term care after the death of both the institutionalized spouse and the community, or non-institutionalized, spouse.

Many attorneys in Vermont are skilled at helping families plan for or respond to a need for long-term nursing home care for a family member. This

section addresses only Medicaid planning in the context of farm transfer planning. How do typical farm transfer tools and strategies affect Medicaid Long-Term Care eligibility? What farm assets are considered available? This section focuses primarily on the implications of typical farm transfer strategies for Medicaid eligibility. It also addresses

the potential for the recovery of farm assets as reimbursement for long-term care costs.

Medicaid rules in effect prior to February 8, 2006 balanced budgetary concerns with measures designed to avoid the liquidation of a family business, particularly where the family business is the sole source of support for heirs. Federally man-

The Deficit Reduction Act of 2005

On February 8, 2006 Congress passed the Deficit Reduction Act. DRA made several significant changes to the Medicaid program. The Congressional Budget office estimates a savings of \$6.4 billion over the 2006-2015 periods by increasing the penalties for transferring assets for less than fair market value and other changes. In summary, the DRA made the following changes to the Medicaid program:

All transfers will have a five year look back period rather than

three.

The penalty period for transfers made during the look back period will begin at the time of program eligibility rather than at the time of the transfer.

Individuals with home equity in excess of \$500,000 will not be eligible for Medicaid.

Applicants with annuities must name the state as a remainder beneficiary to the extent of program expenditures for their care.

Vermont's Department for Children and Families that

administers the Medicaid program will have to promulgate new program rules to come into compliance with the federally mandated changes under the DRA. The DRA provides that the transfer rules are to be effective as of February 8, 2006 although the state continues to process applications under the old rules. As of this writing (April 2006) it is unclear whether applications granted under the old rules will be reviewed once the new rules are promulgated.



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dated changes to the Medicaid rules passed in the Deficit Reduction Act of 2005 will make it much more difficult to integrate Medicaid eligibility with farm transfer planning, however. The changes to Medicaid significantly increase the program penalties on individuals who transfer assets for less than fair market value in order to qualify for Medicaid.

The Vermont Agency of Human Services will be promulgating new administrative rules to bring Vermont into compliance with the federally mandated changes. The federal law, however, mandates an effective date for some of the changes of February 8, 2006. As of this writing, the Agency hasn't made it clear whether cases granted in the interim will be reviewed once the new Vermont rules are in place, making planning that much more difficult.

Resource Limits

Medicaid will consider the assets of everyone in a "responsibility group" in determining eligibility. Generally, a responsibility group is composed of spouses, parents, and their dependent children, parties to a civil union, or others who may be financially responsible for the institutionalized family member.

For 2005, the maximum resource limit for the community spouse – the non-institutionalized spouse – was set at \$95,100²⁹ in cash or other property. The institutionalized spouse may have \$2,000 in resources. The institutionalized spouse

may transfer property to the community spouse in order to meet the eligibility requirements.

Excluded Property

Certain kinds of real property are excluded, meaning they are not counted towards the resource limit in determining eligibility for Medicaid long-term care coverage. But remember that even though these assets may not be considered available to cover the costs of care, they may still be subject to a claim by Medicaid for recovery of the costs of care after the death of both the institutionalized and the community spouse. In addition, pre-application transfers of certain property for less than fair market value may lead to a period of ineligibility. (See "Asset Recovery" on page 64 and "Permitted and Penalized Transfers" on page 62.)

A Home and Contiguous Land

Under the current Vermont Medicaid rules, a person's principal place of residence, regardless of its value, is excluded.³⁰ The exclusion extends to the home itself as well as to any contiguous land and other buildings on the land. Thus, an entire farm and anything growing upon it can be excluded, provided the land is "contiguous." A road running through the property does not affect the exemption, but an intervening parcel owned by another does affect it.

The exclusion applies even if the owner must

be away from the home while receiving long-term care, provided the person intends to return to the home or a spouse or dependent is living there. Even if returning to the home isn't a likely prospect, the exclusion can still apply if there is some indication that the homeowner intends to return. It's a good idea for the homeowner to express the intent to return home in a power of attorney or another estate planning document should they require institutionalization.

Under a rule that appears to defy all logic, homes that have been placed in a revocable living trust are not excluded by Medicaid.³¹ If the home is in a revocable living trust, Medicaid will treat it as available. The home, however, may be transferred out of the trust prior to application for Medicaid and will then be considered excludable. The reasoning for this rule may be the fact that property placed in a revocable living trust will avoid probate. Medicaid's primary method of recovering costs from beneficiaries is through the probate process. By forcing homes out of trust, they improve their recovery prospects.

The Deficit Reduction Act of 2005 will require Vermont to change its rules to exclude individuals from eligibility who have an equity interest in their home in excess of \$500,000. The dollar amount allowed will be increased beginning in the year 2011 in \$1,000 increments to keep pace with inflation. The rule won't apply if there is a spouse or minor or disabled child living in the home. The law also allows for a hardship waiver.³²



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Jointly Held Real Property

The current Vermont Medicaid rules will exclude jointly owned real estate in some cases. Real estate held jointly as tenants in common or as joint tenants may be excluded if:

1. The other joint owner refuses to sell, **and**
2. The joint interest was created before July 1, 2002, **or**
3. The joint interest was created more than 36 months before the date of application for long-term care coverage.³³

The Deficit Reduction Act of 2005 will require Vermont to amend their Medicaid rules to impose a 60 month look back period rather than a 36 month look back for transfers made after February 8, 2006.³⁴

Thus, real estate owned jointly by both the senior and junior generation may be excluded depending on when it was transferred. If the transfer was made within the applicable look back period the entire value of the jointly held resource is usually considered available. Whether the property is held as joint tenants, tenants in common, or tenants by the entirety, Medicaid will count the entire asset unless you can establish that the other co-owners purchased their shares of the property.³⁵ If a purchase can be established, Medicaid will count only the applicant's proportional share.

When the farm real estate is owned jointly but in the form of units in an LLC or shares in a corporation, the rules with respect to exclusion and valuation of an institutionalized spouse's interest are not at all clear. Medicaid does have general rules on jointly held resources.³⁶ These rules are very specific with respect to property held as joint tenants, tenants in common, or tenants by the entirety but provide little specific guidance on valuation of jointly held business assets such as LLC units or shares in a farm corporation.

“Generally, resources are counted based upon their availability and the ease with which they can be converted into cash. Availability is often affected when more than one person has an ownership interest in the same resource.”³⁷ Presumably, availability, as well as the value of an LLC unit, would be a function of the LLC operating agreement. For example, operating agreements that limit re-sale of units to other family members or require all members to agree to a sale outside the family and other factors that also suggest a lack of marketability might arguably lead to either a discounted – less than fair market value of the underlying assets – valuation or a determination that the asset is not available and should be excluded. On the other hand, operating agreements with well-defined valuation procedures and buy-sell rights among members might be valued closer to the proportionate share of the fair market value of the underlying asset.

According to the Vermont Medicaid office,

they have not yet been faced with the question of whether to exclude or how to value LLC units.

Livestock and other Farm Chattels

Many farm states exclude the value of livestock and equipment if it is used to produce income. Vermont exempts home furnishings and household goods, including tools, equipment, and other property required or essential to self support.³⁸ While the Vermont rules don't specifically mention livestock, for many farm families, they are essential to self support.

Life Estates

A life estate is an interest in land that endures for the life of the life tenant. Where there is a life estate, there must also be a “remainder interest” in the property that will pass to whomever is to take the property at the death of the life tenant. If the owner of the life estate does not retain the power to sell or mortgage the “remainder interest,” Medicaid will exclude its value. If, on the other hand, the life estate owner retains the right to sell the entire property, which is also called a “life estate with powers,” the life estate is considered an available resource unless it can be excluded on some other basis. For example, even a life estate “with powers” is excluded if it is the individual's home.³⁹

The Deficit Reduction Act of 2005 requires Vermont to amend their Medicaid rules to provide that a purchased life estate will be included as an asset unless the purchaser has lived in the home for



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at least one year after the date of purchase.⁴⁰

Transferring a home to heirs while retaining a life estate is a common strategy for preserving estate assets from the costs of long-term care. The elder retains the right to occupy the home during his or her lifetime. Its value is considered unavailable for the purposes of Medicaid. At the death of the elder, title to the whole property passes automatically to the heirs without having to go through probate and with a stepped up basis. Avoiding probate also avoids any asset recovery claims that Medicaid may file. This strategy is further discussed in “Asset Recovery” on page 64.

Income Producing Real Property

Farmland that is producing significant income is also excluded. The property must, however, be returning at least 6 percent of its fair market value in net annual income after deducting allowable expenses related to producing the income. Most farmers would have a difficult time meeting this threshold. Thus, farmland that is not contiguous to the home farm would only be excluded if it were returning an adequate net income.⁴¹

Life Insurance

Whole life insurance owned by either spouse with a cash value of up to \$1,500 is excluded. If it has a value of more than \$1,500, it is included. Whole life insurance that is purchased for use in a business buyout or for estate taxes or other liquidity needs related to farm transfer planning purposes should be titled appropriately to the business or

to the junior generation. Term life insurance is excluded by Medicaid.⁴²

Cash Necessary to Operate the Farm

Medicaid also excludes cash needed to run the farm business. Up to three times the monthly average cash operating expenses for the past twelve months can be excluded. Tax returns, business receipts, and expenses may all be used to determine the monthly average.⁴³

Savings Bonds

Savings bonds purchased before June 15, 2004, on which the minimum retention period expires thereafter, are excluded by Medicaid unless they are redeemed, exchanged, surrendered, reissued, or otherwise become available. However, savings bonds purchased after June 15, 2004, will not be excluded unless the owner requests and is denied a hardship waiver based on medical need from the U.S. Department of Treasury.⁴⁴ If the waiver is denied, the savings bond will be excluded until its minimum retention period expires.

Other Exclusions

An automobile, regardless of its value, is excluded. A farm truck may also be excluded if it is used to provide transportation. A burial fund of up to \$10,000 is also excluded.

This is by no means an exhaustive list. See the Vermont Department for Children and Families (DCF) rules for a complete list available on line here: <http://www.dsw.state.vt.us>.

Permitted and Penalized Transfers

Certain transfers of income or resources by anyone in the financial responsibility group to someone outside the responsibility group may be penalized by Medicaid. These disfavored transfers may result in a period of ineligibility for coverage. How long the period of ineligibility lasts is a function of the date of the transfer and the value of the resource transferred.

Any transfer for fair market value is allowable. Thus, where the junior generation is purchasing a share of the farm or farming operation, no penalty period results as a result of the transfer of farm assets. However, these transactions should be well documented, especially where a junior member is contributing sweat equity for a share of the farm.

In addition, transfers of income or resources other than a home that would have been excluded are also allowable.⁴⁵ The transfer of an automobile, for example, would not result in a penalty period because an automobile of any value is an excluded resource.

Certain transfers for less than fair market value are also allowable. With the exception of certain kinds of property transferred to a trust, as discussed in “Transfers of Property to a Trust” on page 63, the current Medicaid rules in Vermont provide that any transfer made more than 36 months prior to the date of application will not result in a penalty period. As a consequence, if a gifting of farm assets is made 36 months prior to the date of application, it should not result in a period of ineligibility.



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The Deficit Reduction Act of 2005 will require Vermont to amend their rules to provide a 60 month look back period for transfers occurring after February 8, 2006.⁴⁶

Under the current rules a transfer by gift of farm assets made within the look back period may be allowable if the applicant can demonstrate that the transfer was made exclusively for a purpose other than qualifying for Medicaid.⁴⁷ For any transfer, there is a rebuttable presumption that the transfer was for the purpose of establishing eligibility for Medicaid. To overcome this presumption, the applicant must present convincing evidence that the resources were transferred exclusively for another purpose. The Medicaid rules include a number of examples of convincing evidence, as listed below.

Examples of evidence from the Medicaid rules include:

- The transfer was not within the individual's control, e.g., was ordered by a court;
- The individual could not have anticipated long-term care eligibility on the date of transfer, e.g., the individual became disabled due to a traumatic accident after the date of transfer; or
- A diagnosis of previously undetected disabling condition leading to long-term care eligibility was made after the date of transfer.⁴⁸

Regular gifting of farm assets, as part of a farm

succession plan, should arguably fit within this rule. Convincing evidence in this context might include:

- An operating agreement or partnership agreement indicating that a primary purpose of the entity is to facilitate an orderly transfer of the farming business from one generation to the next.
- A written business or farm succession plan outlining an orderly annual gifting plan to transfer the farm to the next generation.
- A consistent pattern of gifting initiated during a period in which a need for long-term care could not have been anticipated.

The Vermont Medicaid office has said that this exception has never been used in the context of a farm or small business succession. Establishing this rule's applicability to avoid a penalty period might require using the administrative appeals process or litigation. It is also unclear how and whether the amendments which must be made as a result of the Deficit Reduction Act might affect this rule. Some commentators suggest that the purpose of the transfer is no longer relevant and that even if the transfer is made for a purpose other than qualifying for Medicaid it will be penalized.⁴⁹

Transfers of Property to a Trust

A transfer of assets other than a home to a revocable living trust can result in a penalty period unless the transfer occurred 60 months prior to the ap-

plication for long-term care coverage or in the case of an irrevocable trust, 36 months before applying for long term care.⁵⁰

As discussed above, under a rule that appears to defy all logic, a home placed in a revocable trust is always considered available regardless of when it was placed in trust.⁵¹ The home, however, can be removed from the Trust and will then be considered an unavailable resource. The reasoning for this rule may be the fact that property placed in a revocable living trust will avoid probate. Medicaid's primary method of recovering costs from beneficiaries is through the probate process. By forcing homes out of trust they improve their recovery prospects. (See "Asset Recovery" on page 64.)

Revocable trusts are good planning tools for transferring a family business. A successor trustee can oversee assets until the heirs are capable of taking over the business, for example. There are good reasons to put family business assets into a revocable living trust irrespective of how Medicaid might treat the transaction. Given the 60 month rule, however, it would appear that the sooner families utilize this planning tool, the better.

For some trusts — those which are irrevocable and where no disbursements for the benefit of the applicant are allowed — the look-back period is just 36 months.⁵²

The Penalty Period

If a transfer is disallowed — as is a transfer made during the look-back period — Medicaid will impose a penalty period during which no payments



will be made for long-term care services.⁵³

The penalty period is equal to the total value of all disallowed transfers made during a given calendar month divided by the average daily cost to a private patient of nursing facility services as of the date of application.⁵⁴

Under the current rules the penalty period begins on the date of the transfer and as result quite often the penalty period has expired long before the individual requires care. For example, assume a grandmother makes a one-time transfer of her farm partnership interest to her grandson. Her capital account indicates that her partnership interest is worth \$100,000.⁵⁵ Assume further that 24 months later she applies and is eligible for Medicaid long-term care coverage. Assuming an average daily cost for nursing facility care in Vermont of \$150, the penalty period would be 667 days (\$100,000 divided by \$150) or nearly 23 months. The penalty period would expire before she needed coverage.

The Deficit Reduction Act of 2005, however, will require Vermont to amend their rules to begin the penalty period on the date the individual otherwise becomes eligible for Medicaid. In the above example, the Grandmother would be denied coverage for 23 months after her application and qualification for Medicaid.

Under the current rules and under the Deficit Reduction Act, Medicaid will not establish a penalty period where it would result in an undue hard-

ship. The Medicaid rules include several examples of undue hardship including the following: Where “funds can be made available for medical care only if assets such as a family farm or other family business are sold, and the assets are the sole source of income for the individual’s spouse, parents, children or siblings.”⁵⁶ The Deficit Reduction Act directs each state to provide an application for an undue hardship waiver where the penalty period would deprive the individual of medical care such that the individual’s health or life would be endangered or the individual would be deprived of food, clothing, shelter or the necessities of life.⁵⁷

Asset Recovery

Federal law requires states to recover assets from the estate of any institutionalized family member over age 55 to offset the costs of the long-term care paid for by Medicaid. The Vermont Department for Children and Families will file a claim with the probate court as a creditor of the estate for these expenditures only after the death of the surviving spouse.⁵⁸

Because the Department’s only means of recovery to date is through probate, non-probate assets are not subject to recovery. Non-probate assets include property that passes automatically at death, such as property held in joint tenancy, the remainder interest in a life estate, or assets that were trans-

ferred to a living trust. The Department will file a claim with the probate court as a creditor of the estate to recover its expenditures for long term care – but only after the death of an individual’s surviving spouse.

The following exemptions apply to property that goes through probate:

- Homestead property with a value of less than \$250,000 is exempt from estate recovery where a sibling, a child, or a grandchild will inherit the property and the heir either meets certain income guidelines – 300 percent of poverty – or they provided significant services or financial support that enabled the person to avoid or delay long-term care.⁵⁹
- There is also an undue hardship exemption from estate recovery. Heirs may seek an exemption when recovery of an income-producing asset – such as a farm or other business asset – would create an undue hardship to the decedent’s family members.⁶⁰ When the assets alone or in combination with other assets are the sole source of income for the decedent’s spouse, parents, children, or siblings, or where recovery would render these family members eligible for public assistance, the Department for Children and Families will not seek recovery.⁶¹



Medicaid Eligibility and Permitted Transfers in Vermont

Allowable Assets:

- \$95,100 in cash or other property (non-institutionalized spouse)
- \$2,000 in cash or other property (institutionalized spouse)
- For applications made after January 1, 2006, individuals with more than \$500,000 equity in a home are not eligible.

Excluded Property:

- A home and contiguous farmland regardless of value (unless in a revocable living trust).
- Some jointly held real property if joint interest created 36 months prior to application or 60 months for transfers after February 8, 2006.
- Income producing livestock and equipment if essential for self support.
- A life estate in real estate (if owner of life estate does not retain power to sell or mortgage the remainder interest).
- Farmland (not contiguous to a home)

earning a net annual income of at least 6 percent of its fair market value.

- Cash necessary to operate the farm.
- Auto/farm truck used for transportation.
- Other exclusions: see DCF rules.

Permitted Transfers:

- Transfers for fair market value.
- Transfers of excluded property, other than a home.
- Transfers, other than to a trust, of property made at least 36 months prior to the date of application, or 60 months for transfers after February 8, 2006.
- Transfers of property, other than a home, to a revocable living trust if made at least 60 months prior to application.
- Transfers to irrevocable trusts for the benefit of another if made at least 36 months prior to application, 60 months for transfers after February 8, 2006.
- Transfers made exclusively for a purpose other than qualifying for Medicaid. Client must establish with evidence such as a farm transfer plan, pattern of transfer, etc.

Farmland Tenure



and Leasing

By Annette Higby



Land Tenure Patterns in Vermont

The latest U.S. Census figures indicate that nearly 40 percent of Vermont farmers lease land or operate under some other form of non-ownership tenure.¹ Thirty-three percent of the farms reporting in the 2002 Census in Vermont characterized themselves as “part owners” who own part of their farm and rent part of their farm. Six percent of the farms identified themselves as “tenants”² who rented all of their farmland.

In 2002, 295,082 acres of Vermont farmland were farmed under some form of non-ownership tenure — a great deal of it under an oral or written cash lease.³ The Census doesn’t include data on the terms of these leaseholds. Nationally, and perhaps in Vermont, an annual and oral cash lease that can be terminated at the will of the landowner is the norm. Vermont tenant farmers may fare better because in some instances, landowners must have a written three-year lease with a farmer to qualify for Vermont’s agricultural land use value program, which is known as “current use.”⁴

The terms of non-ownership tenure can have a tremendous impact on how property is cared for and used. Recent studies confirm what we all know intuitively — oral and year-to-year leases offer little incentive to use resource-conserving farm-

ing practices, while long-term leases that offer relatively secure tenure stimulate good management.⁵

Insecure tenure can either complicate the planning horizon of beginning and landless farmers or provide needed flexibility for a new operation just finding its niche. Whether help or hindrance, a short-term, oral lease is often the only way a beginning farmer can gain access to land. Rising land values — farmland valued on average at \$1,138 an acre in 1988 was worth \$2,704 an acre by 1999⁶ — make leasing an essential start up strategy.

Beginning farmers are competing for land not only with established farmers but also with non-farmers who want to own a piece of rural Vermont. In 1999, USDA estimated that 30 percent of Vermont’s croplands, pastures, and forested woodlands was owned by what they call “non-operators,” landowners not involved in farming their property. In 1988, the figure was just 8 percent.⁷ A significant share of Vermont’s productive resource base is now owned by those who do not work it and worked by those who do not own it. This land tenure pattern — which is even more extreme in other parts of the U.S. — has consequences. It affects the way the land is used, the care it is given, and even extends into the quality of community life. Rural sociologists report that communities

with high rates of farm tenancy have weaker social institutions than communities characterized by farm ownership.⁸

Giving beginning farmers a chance of success has always required a public investment. The Farm Services Agency has historically provided credit to farmers who were starting out and who were “unable to obtain credit elsewhere.” Since the 1930s, FSA has been the lender of last resort and, as such, has made farm ownership a reality for thousands and thousands of farm families. However, the current level of public commitment to providing economic opportunity and entry into agriculture leaves much to be desired. In 1997, FSA’s share of lending in the Northeast had dwindled to 6.7 percent — not much ahead of implement dealers as a source of credit. Annually, FSA in Vermont makes an average of one to two direct farm ownership loans to beginning farmers. Some FSA funds allocated for guaranteed loans for beginning farmers — where FSA bears 90 to 95 percent of the risk of default for commercial lenders — have gone unused.

Rising land values, a dearth of credit, and the narrow profit margins earned by conventional farming have conspired to make leasing or some other form of non-ownership tenure a fact of life for most beginning farmers.



FARMLAND TENURE AND LEASING

Vermont's Land Use Value Program (Current Use)

Vermont's land use value⁹ program, most often referred to as Current Use, provides tax incentives aimed at keeping the Vermont landscape in active agricultural use.

For qualifying farm and forest land, there are several tax benefits:

- Farmland enrolled in current use is valued for property tax purposes as if it were "required to remain henceforth in agricultural or forest use" rather than at its highest and best use or as property that could be developed.
- Farm Buildings on enrolled land are valued at zero for property tax purposes.
- Transfers of property enrolled in the property pay the transfer tax at a lesser tax rate than other property if the property remains enrolled for three years.¹⁰

To qualify, agricultural land exclusive

of a two-acre home site must be at least 25 acres in size, with one exception described below, and must be in "active" agricultural use. The land is presumed to be in agricultural use if it is owned by a farmer or is leased to a farmer under a three-year lease. A "farmer" is anyone who earns at least 50 percent of gross income from farming.

Farmland, including parcels less than 25 acres, may qualify under an income test as well. Smaller parcels that produced an annual gross income from the sale of farm crops of at least \$2,000 in one of two, or three of the last five calendar years can qualify. Larger parcels – more than 25 acres – must generate an additional \$75.00 per acre for each acre over 25 or a total of \$5,000, whichever is less. In recent years, the legislature has amended the current use statute to include a broader definition of "farmer" and "farm crops." For example, the

statute now provides that a farmer is also one who produces farm crops that are processed on the farm and whose gross income from the sale of processed products, when added to other gross farm income, is at least one-half of all of his or her gross annual income. Seventy-five percent of the processed product must be produced on enrolled land.

Farm crops now include animal fiber, cider, wine, and cheese processed from products produced on the farm as well as the more traditional crops of hay, cultivated crops, pastured livestock, fruit trees, and maple syrup production.

The definition of farm buildings has also expanded to include not just those structures actively being used in the farming operation, but also up to \$100,000 in a farm facility used for processing farm crops, provided a minimum of 75 percent of the crop is produced on the farm.

When land that has been enrolled in current use is developed or subdivided, a land use change tax is imposed upon the owner. As of July 2006, the tax is equal to 20 percent of the full fair market value of the land that is changing use or 10 percent if the land has been enrolled in current use for 10 years. If only a portion of the land is changing use, the fair market value is prorated. There is a provision for the reduction of the land use change tax if the change in use was the result of the death or incapacity of the farmer.¹¹

Vermont's land use value program seems to undergo legislative revision on a regular basis. It's important that you look at the current statute rather than materials that may be out of date. The general information available on the Vermont State Department of Taxes Website on current use, for example, hasn't been updated since 2002.



FARMLAND TENURE AND LEASING

The Value of a Lease

The relationship between the landowner and the farmer is always more important than the written document, but a written agreement can give the relationship a more solid footing. If the relationship sours, a written agreement can settle some of the many disputes that can arise.

Many farm states in the Midwest have landlord-tenant statutes that govern farm leases. Many of these statutes dictate how and when a

lease may be renewed. Some grant the landowner a lien on the tenant's crop to secure the payment of rent. Nebraska even gives an income tax break to non-farming landowners who rent to beginning farmers. These statutes serve to keep disputes out of court by filling in the gaps when the parties have only an oral or "handshake" agreement. Vermont doesn't have a special statute governing farm leases. Nor does it

have a beginning farmer tax break or a landlord lien. Most of Vermont's law governing the landlord-tenant relationship – with the significant exception of residential leases – is governed by judge-made law or case law.

In the absence of a written lease, the courts look to certain statutes and previous cases to settle a dispute. It's much simpler and much, much less expensive to have a written lease.

Get it in Writing

Vermont law, as well as laws of most other states, requires that certain kinds of agreements be in writing. These laws are known as the "statute of fraud," and they almost universally say that agreements regarding real estate are unenforceable in court unless they are in writing and

are signed. The Vermont statute of frauds¹² has been interpreted by the courts to apply even in cases where the other party admits that there was an oral agreement.¹³ If the agreement isn't in writing, a Vermont court will not enforce it.

The statute of frauds applies not only to the

original lease but also to any significant amendments to the lease agreement. Amendments to the lease must also be in writing. If the lease is signed by an agent of the landowner, the authorization from the landowner must also be in writing.



FARMLAND TENURE AND LEASING

Agricultural Lease Checklist

1. Who are the parties? Is there evidence of ownership and authority to act if the landowner is an entity such as a Partnership, LLC or Corporation rather than an individual? Is the tenant an individual or an entity? Will the lease also bind the heirs or future purchasers of the property?
2. What is the lease term? Will it terminate on a specific date or will it end at the will of one or either party? If terminable “at will,” how much notice will be given to the other party?
3. Is the lease renewable? Is renewal automatic? Do both parties have the
- option to renew or not renew? What is the procedure for renewing the lease?
4. Does the lease include an adequate description of the property – land, farm structures, residence, equipment, and livestock – that is to be leased?
5. How much and what type of rent will be paid and how and when must it be paid?
6. If the agreement includes a residence, is there a separate residential lease?
7. What are the allowable and
- prohibited uses of the property under the lease? Does it allow interns to be housed on site or a farm stand operation?
8. How will the landowner and the land user allocate responsibility for repairs and maintenance of the property?
9. How will the landowner and farmer allocate responsibility for capital improvements? If the land user invests in capital improvements, how will he or she be compensated at the end of the lease? Or, does the rent reflect those capital investments?
10. Who will be responsible for obtaining and maintaining insurance – liability, casualty, and crop?
11. What actions by either party will constitute a default under the lease? Will the non-defaulting party have the right to terminate the lease or withhold rent until the default is cured? Will the lease include an alternative dispute resolution procedure such as mediation or arbitration?

Essential Terms of an Agricultural Lease

Parties to the Lease

The lease must effectively bind the actual owner of the property. If the land is owned by a limited liability company, for example, the lease must be signed by a member of the LLC with the author-

ity to bind the company. If the land is held in a trust, the lease must be signed by the trustee of the trust. You can find out who owns the property by looking at the deed in the town records. Tenants who are organized as limited liability entities may be asked to sign the lease as individuals and to be

personally liable for the rent.

Parties to the lease may also bind the “heirs and assigns” of each party, meaning that the lease will remain in effect even if the landowner passes away or the property is sold to another. To effectively bind third party purchasers, however, the lease or



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a memorandum summarizing the lease must also be filed in the town land records.¹⁴

The Lease Term

A lease term that allows a farmer to reap the benefits of soil-saving or other conservation practices can benefit both the landowner and the farmer. A lease term of at least three years will also ensure eligibility under Vermont's Current Use program.

If the lease is to be terminated at the will of the other party instead of a definite term, an appropriate notice period should be included in the lease. A six-month notice period seems typical for most farm leases but may not be adequate given the nature of the farm and the farm business. A six month notice allows the tenant time to find a suitable replacement property.

Renewal terms and methods of notice of intent to renew or not renew should also be specified in the lease.

Setting the Rent and Types of Leases

Many factors can help to determine a rental rate for Vermont farmland or farm buildings. Facility rent – a dairy barn, for example, is frequently set on a per head or per stall basis and not surprisingly, rises and falls with the price of milk. Dairy barn rental rates, however, haven't risen much since the 1970s in Vermont and still hover around \$10 to \$15 per stall. Whole farm rent may be based on the land-

owners' desire to cover all or a large portion of their land costs—real estate taxes, insurance, repairs, and depreciation. A common formula to determine rent is “DIRTI” or Depreciation, Interest, Repairs, Taxes and Insurance. Some landowners set a whole farm rental based simply on the residential rental value of the property or what they could get by renting to a non-farmer commuter with no interest in using the farmland. Rent can also be set based on the market rental rates for comparable farm land in the area or a combination of all these factors. Extension agents and local farmers will have an idea of average land rents in their area.

Some landowners will accept a lower than average rental amount because of their belief in the social benefits of local food production or providing an opportunity to a beginning farmer. Others accept a lower rent if the farmer can help them meet stewardship goals for the property. For example, allowing a farmer to hay a meadow for free can save a landowner the expense of mowing it and putting livestock on pasture can control weeds, add nutrients, and improve the property.

Most Vermont leases are straight cash leases – in return for a specified payment, the farmer has use of the property for a specified period – but there are many alternatives to the cash rent lease, as discussed below.

Crop/Livestock-Share Rent

In a crop- or livestock-share rent, the farmer and landowner share both the expenses of bringing the

crop to market and the profits. A share lease, for example, may split the production costs and profits 50/50 or by some other negotiated split. Crop-share leases are more common in the Midwest, but their advantages for beginning farmers are equally applicable in Vermont. A crop- or livestock-share arrangement can significantly reduce a farmer's annual outlays in cash rent, interest, and other production expenses. A share lease also shifts some of the risk of profit or loss to the landowner.

Flexible Cash Rent

Flexible cash rents are a hybrid between a straight cash lease and a share lease. A “base” cash rent is set that assumes low production and a low commodity price. If actual production and prices exceed the base, the landowner receives a share of the additional profit. The base rent can be set to just cover the landowner's fixed costs or the fixed costs plus a modest return. Flexible cash rent can reduce the risk for the farmer and reward the landowner in good years.

Net-Share Leases

In a net-share lease, the landowner is entitled to a specified share of the farm's crop in payment as rent. If the farmer has a good year, so does the landowner. However, the farmer bears most of the production expenses. Net-share rent options are most often associated with cash-crop farming, but they can also be used in dairy, fruit, vegetables, and hay.



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Taxation of Rental Income

The IRS treats rental income from farmland differently than it does other kinds of rental income. The difference is that landowners who **materially participate** in the production of crops or the management of the farming operation must include the rental income in earnings subject to self-employment tax. However, landowners who do not materially participate do not have to pay a self-employment tax on that rental income. Government payments that a landowner receives as a result of a crop-share tenant's participation in a government program may also have to be included in self-employment income.

Definition of Material Participation

According to the IRS 2002 "Farmer's Tax Guide," a

landlord materially participates if the arrangement with a tenant specifies the landlord's participation and he or she meets one of the following tests:

The landlord does any three of the following.

- Pays, using cash or credit, at least half of the direct costs of producing the crop or livestock.
- Furnishes at least half the tools, equipment, and livestock used in the production activities.
- Advises or consults with the tenant.
- Inspects the production activities periodically.
- The landlord regularly and frequently makes, or takes an important part in making, management decisions that substantially contribute to or affect the success of the enterprise.

- The landlord works 100 hours or more, spread over a period of 5 weeks or more, in activities connected with agricultural production on the rental property.
- The landlord does things that, considered in their totality, show that he or she is materially and significantly involved in the production of the farm commodities on the rental property.

Landowners who provide production financing or a significant percentage of the tenant's equipment and who periodically inspect the property to ensure that agreed-upon farming practices are being followed are more likely to be considered material participants.

Residence on the Farm

When a residence is included in the rental agreement, a farm lease necessarily takes on both commercial and residential elements. Vermont law regulates residential rental agreements to ensure safe and habitable living conditions for tenants. The Vermont statute sets certain minimum standards that cannot be modified by a lease. The law requires that the premises be safe, clean, and fit for human habitation. For example, residences must have adequate heat, hot and cold running water, and comply with applicable building housing and health regulations.¹⁶ By the terms of the statute, any lease that tries to avoid this duty shall be unenforceable and void. Farm leases are not exempted from complying with the residential rental agreement statute. Farm tenants, therefore, have the same rights to safety and habitability as other tenants, no matter what the lease says.

Allowable and Prohibited Uses

The lease should specify any uses of the property that may be permitted, prohibited, or conditional. Landowners may want to specify whether the land is to be limited to certain types of production, e.g., only pasture or hay land, or if there are other restrictions or requirements regarding uses appropriate to the soils or topography of the farm. It's



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appropriate to attach a map to the lease indicating where certain practices are allowed or prohibited or indicating a preferred crop rotation.

Farmers should include specific authorization in the lease to conduct those activities essential to the success of their operation. If a farm stand, housing interns, or making and selling compost from the farm property is part of the farm plan, be sure that it is part of the lease.

Leases often “incorporate by reference” statutory or regulatory prohibitions of certain farm practices. For example, leases typically require the tenant to adhere to Vermont’s accepted agricultural practices. A lease for land that has been “conserved,” or protected by an easement or “conservation restriction,” is likely to include a provision requiring the tenant to comply with the terms of the easement. Landowners may also require compliance with USDA/NRCS farm conservation plans or those of another USDA program. Leases for farms enrolled in Current Use Real Estate Tax Abatement programs typically require that the tenant refrain from any practice that would jeopardize eligibility for the program.

Landowners may also ask tenants to refrain from activities that would trigger Act 250 jurisdiction or go beyond the agricultural exemption from zoning. (See Water Quality and Environmental Regulation, Chapter VI, page 113.)

Repairs and Maintenance

In practice and at common law, the farm tenant is most often held responsible for routine repairs

and maintenance. The landowner, however, is often responsible for major repairs, rehabilitation, or replacement of farm structures or systems such as:

- Structural components including barns and fences
- Exterior siding
- Roofing
- Water supply systems
- Waste treatment systems
- Heating and ventilating systems

The tenant is frequently responsible for necessary routine maintenance and repair of systems, such as annual servicing, repainting, or staining, in order to prevent their deterioration.¹⁷

Repairs and maintenance are fertile ground for disagreements and disappointments between landowner and farm tenant. The landowner wants the property to remain in good repair. The tenant with a short-term lease isn’t motivated to make investments that may primarily benefit the landowner. A longer lease, an annual “walk around” with a check list, and an annual limit on expenditures expected of the farm tenant may minimize some of the problems that can arise in this area.

Capital Improvements

Capital improvements include everything from constructing or renovating permanent farm structures, installing soil conservation structures, erect-

ing permanent fencing, and tiling fields to practices or soil amendments that build long-term soil fertility. Vermont farm land or farm buildings left idle for long periods often require a significant investment of labor and money to bring back into productive and profitable use. These are the properties most commonly available to beginning farmers. Properties leased under year-to-year leases for many years can share some of the same characteristics as property that has gone unfarmed for many years.

Properties that require significant capital investment before profitable farming can even begin require special caution. Beginning farmers, many of whom are so excited about their first opportunity to farm that they can’t wait to “improve the place” need to make a realistic assessment of the economics of farming a property that requires a significant investment of human or financial capital.

Permission

Tenants should never undertake a capital improvement without the consent of the landowner. Ideally, needed capital improvements should be discussed on an annual basis along with repairs and maintenance. Farmers should describe the needed improvement—its location, construction methods, and other important factors—in writing and ask the landowner to sign this document to indicate agreement. The document should also indicate the landowners’ and farmers’ respective shares on the expense and labor as well as ownership of the improvement at the end of the lease term.



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Severance

In instances where the tenant wants to construct a removable structure such as a greenhouse, the lease can allow the tenant to remove the structure at the end of the lease period. The lease needs to be specific about the tenant's owning the structure because at common law, any structure on the property, regardless of who bears its construction costs, belongs to the landowner at the termination of the lease. Provisions that name the tenant as owner of a structure and also permit the tenant to remove it at the end of the lease period typically require that the tenant bear the costs of removal and restoring the land to its former condition. The lease may also provide that instead of removal, the tenant has the right to sell the structure to the next tenant.

Permanent Structures

For more permanent structures that cannot be removed, the landowner may be willing to pay for construction or renovation if it will increase the value of his property and provide a long-term financial return. The Use Value Appraisal program in Vermont helps to encourage landowners to keep farm structures on their property in active agricultural use. The Current Use Statute provides significant real estate tax advantages on farm structures. Farm structures on enrolled farms under a three-year lease to a farmer can receive a "use value appraisal" on the farm building of ZERO percent of its fair market value.¹⁸ A landowner can construct a new farm building or make major renovations to an existing structure without suffering a big jump

in the real estate tax bill. Farm buildings include farm improvements used as part of the farming operation including up to \$100,000 in value of structures used for processing the farm's crops and housing for farm labor. It does not include the farmer dwelling, however.

A tenant may be willing to pay for construction if the lease term is long enough to allow earning an appropriate return on the investment. A lease term that runs for the useful life of the investment would allow the tenant to earn a return on the investment. The lease may commit the owner to pay the tenant the depreciated value of the structure at the end of the lease period. The lease may also pro-

vide that in the event the landowner sells the land to the tenant, the depreciated value of the structure or other capital improvements be deducted from the purchase price. You can use the applicable IRS depreciation rate for the particular kind of property involved or devise your own based on the property's useful life.

Improving Soil Productivity

Farm tenants continually struggle with whether and how much to invest in the long-term productivity of a leased property. Many farm tenants express frustration that their contributions toward

Repair vs. Capital Improvements— According to the IRS

What's the difference between repair and maintenance and a capital improvement?

The IRS has a useful test to help you decide if an expenditure is a deductible repair or a capital improvement. Generally, a repair is an expenditure that keeps the property in its ordinary, efficient, operating condition or restores the property to its original operating condition. A capital improvement, on the other hand, materially enhances the value of the property or substantially prolongs its useful life. Adapting a property to a new or different use is also considered a capital improvement.¹⁹ The

tenant can deduct the cost of repairs from annual income when calculating taxes. In contrast, the landowner's costs for any capital improvements are added to his or her tax basis in the property.

Repair generally includes: painting, replacing broken windows, fixing the plumbing or wiring, replacing belts or other equipment parts, repairing feeders or waterers, replacing fence posts, and mending fences. Capital improvements include: replacing an engine, installing new plumbing or wiring, removing and replacing asphalt roofing shingles, installing fencing, or original painting of a property.



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improving or sustaining the long-term productivity of the farm's soil go unrecognized. Landowners, on the other hand, sometimes express frustration with their tenants' lack of concern over erosion, water quality, wildlife habitat and the consequences to the soil of planting the same crop in the same field year after year.

Without a doubt, the most important factor affecting stewardship on rental land is the length of the lease. In a 2001 study conducted in Iowa, researchers examined the relationship between farm practices and renting farmland. They concluded that farming on rented land "often presented additional barriers to the adoption of sustainable agriculture."²⁰ Not surprisingly, sustainable agriculture was defined in various ways, but a common denominator was "a set of managerial practices to limit resource depletion [or

to] preserve or sustain the resources."²¹

In some cases, the landowner was reluctant to consider practices such as reducing herbicide use because he wanted the land to look "neat and tidy" or he was worried about lower yields that would mean lower crop-share income or a crop failure and subsequent non-payment of rent.

On the tenants' side, the prevalence of year-to-year, annual rentals posed the biggest barrier to adopting soil-conserving farm practices. The study noted, for example, that "sustainable techniques of production, such as conservation and organic methods, require long-term investments in management and sometimes equipment. The instability of tenure inherent in rental arrangements, communication issues, and conflicting goals for the land may lead to difficulties in adoption even when one

or both parties in the landlord-farmer relationship wishes to implement sustainable techniques of production."²²

Many production and resource conservation practices, such as building the soil's organic matter and establishing riparian buffers, can be time consuming and costly to a farmer. It makes no economic sense for a tenant to invest in a practice that won't show a return until after the agreement has ended. Most farm operations are a complex interaction of economic, environmental, and human systems. In many instances, integrating these systems in a way that balances income and other needs with resource conservation goals is an ideal that can take years to achieve. The longer the agreement, the more incentive there is to perform "sustainable" practices or install conservation measures.

Stewardship and the Farmer's Bottom Line

For some farmers, farming practices that eliminate or minimize the use of chemicals on the farm and protect soil and water resources may lead to increased farm profitability. Farmers who can substitute labor and resource management for purchased inputs will fare better over the long term. Good stewardship, however, can also impose short-term costs and negatively impact the farmer's bottom line. Unfortunately, there are few models for farm tenants who want the lease to reflect these costs or for landowners who want to incorporate stew-

ardship standards into a lease. As described below, the Countryside Initiative²³ developed a model for an income-based approach and a new NRCS program is developing an incentive-based approach to addressing the costs of good stewardship.

Income-Based Incentives

The Countryside Initiative is an effort of the Cuyahoga Valley Countryside Conservancy (CVCC) that is designed to bring idle farm home-

steads in the Cuyahoga Valley National Park back into active production. In an effort to provide park and recreation opportunities for the urban dwellers in Akron and Cleveland, the farms were purchased in an aggressive land acquisition effort in the Cuyahoga Valley that began in the 1920s.

CVCC is offering 25-year leases for these farms. The leases set tough stewardship standards, provide income incentives for farmers if they adopt certain farm practices, and encourage enhancing the productivity of the farms. The lease takes a



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pro-rata, or proportional, share of the farmer's gross farm income for rent. The pro-rata share increases over time as the farm productivity increases along with farm income. In recognition of the time required to establish markets and build the income and productive capacity of the operation, the pro-rata share rises by half a percent over the course of the first ten years of the lease. If the farmer achieves organic certification, the pro-rata share paid to the landowner is reduced by one percent.

A more detailed description of the CVCC initiative in the Cuyahoga Valley National Park along with links to their model lease and requests for proposals are available on line here: http://www.cvcountryside.org/Website/countryside_initiative/cvnp_farming.htm.

Incentive and Cost-Based Approach

Another possible model for rewarding stewardship can be found in a new program created in the 2002 Farm Bill called the Conservation Security Program (CSP). As of the 2006 program year, the CSP is available only in certain watersheds in Vermont; the Otter Creek and West River Watersheds and the Hudson-Hoosic Sub Watershed Basin. It is expected that the CSP will be expanded each year until it is available throughout the state.

The CSP will make payments to farmers who enter into five to ten-year contracts with the Natural Resources Conservation Service, promising to undertake certain resource-conserving farming practices on working lands – cropland, grassland,

pasture and forestland that is part of a farming operation. These practices address either soil or water quality resource concerns. Unlike many conservation programs, the CSP does not require farmers to take land out of production. The program also favors farmers who are already using these practices and have already achieved a certain minimum level of conservation. The CSP seeks to “reward the best and motivate the rest.” A CSP fact sheet is available on-line at: http://www.nrcs.usda.gov/programs/csp/pdf_files/csp_fs3_05.pdf.

Depending on the contract and the number of resource issues addressed and practices undertaken, CSP payments will include a 5 percent (Tier I), 10 percent (Tier II) or 15 percent of a “base payment” for farmers who are meeting certain minimum conservation standards. The base payment is tied to the average rental rates for the area. In addition to the base payment, the program provides a cost share payment for implementing and maintaining the conservation practices of 75 percent, or 90 percent for beginning farmers. In addition to the base payment and the cost share payment, farmers may also receive certain “enhancement payments” for practices with conservation results that exceed the minimum standards set by NRCS for each respective tier.

For example, a dairy farm in Vermont might receive a Tier 1 base payment for testing soils and manures to manage nutrients, for adopting a rotational grazing system, or for incorporating green manures—all of which will result in the farm's meeting the minimum level of soil and water quality protection set by NRCS on just a part of the farm. Tier II payments might

be made available for implementing several practices over the entire farm that reach the higher standard of resource conservation for Tier II payments, as set by NRCS, and agreeing to adopt at least one additional practice by the end of the contract. Tier III payments would be made to farmers who have addressed all of the farm's soil and water conservation concerns to standards set by the NRCS Field Office Technical Guides for Tier III. Cost share and enhancement payments would be made where the farmer exceeded the minimum NRCS standards for each Tier.

Eligible practices include crop rotations, cover crops, tillage practices, prescribed grazing, providing adequate wind barriers, using filter strips, terraces, grassed waterways, managed access to water courses, and nutrient and pesticide management.

The CSP is still evolving and payment formulas and other aspects of the program are likely to be modified as NRCS and farmers gain experience with the program. The program's relevance in the leasing context is that the CSP strives to put a dollar value—the base payment—on meeting certain measurable conservation standards set by the NRCS. It also tries to quantify the costs and benefits of maintaining a particular conservation practice and to reward additional conservation efforts through enhancement payments. A table of stewardship payments for the West River watershed for example, can be found at: http://www.vt.nrcs.usda.gov/programs/CSP/CSP_2005/Stewardship%20Payment%20Rate%20West%20River.pdf.

A table of costs for implementing and maintaining certain enhancement practices in Vermont can



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be found at: ftp://ftp-fc.sc.egov.usda.gov/VT/Programs/CSP/CSP_2006/Vermont_2006_CSP_Cost_List.pdf.

The CSP's relevance in the leasing context is that it tries to place a value on the farmer's efforts to conserve soil and water. However, the CSP program is complex and payments will be based on actual conservation performance as measured by NRCS professionals. But its tables and rates may provide at least a basis for negotiation between a landowner and conservation-minded tenant as they set a rent which rewards and compensates the farmer for contributions to soil and water conser-

vation. In conjunction with NRCS conservation plans that aim for a Tier I, Tier II, or Tier III level of conservation, the various rate tables might be more meaningful – and measurable.

Avoiding "Waste"

The case law or judge-made law in Vermont imposes certain minimum stewardship standards on farm tenants. Under the common law, farm tenants in Vermont have an implied duty to farm in a "good and husbandlike manner" and to return the property to the owner in substantially the same

condition as when their occupancy began, reasonable wear and tear excepted. Tenants who breach this duty can be held liable for "waste," which is damage done by the tenant beyond ordinary wear and tear through unreasonable or improper use, abuse, or mismanagement. The courts in Vermont have found a tenant liable for waste where alfalfa was overgrazed and damaged, where water lines were left to freeze, where equipment was not maintained, and where fences were not kept in good repair.²⁴ Because this duty of good husbandry is implied under the common law, a tenant can be held liable for waste without a written lease.

Insurance and Liability Issues

The rules governing the landowner's and the land occupier's responsibilities to third parties are complex. Vermont follows the traditional approach to landowner liability that imposes varying standards of care depending on whether the injured third party was a "business invitee," a "social invitee," or a trespasser.

The law imposes liability on the "possessor" of the land, or the party who occupies or controls its use and maintenance. In farm lease situations, the tenant is usually in control of the premises. If the tenant is keeping livestock and is responsible for maintaining the fences, he or she will be held liable if the fences fail and cause damage. However, in some cases landowners have been held liable if they agreed in the lease to keep the premises in

good repair and the tenants or their guests suffered injury as a result of the landowners' failure to competently honor that commitment. But most often, owners have been held liable in a residential rather than a farm lease situation. Landowners have also been held responsible for "common areas" that are under their control and are used by all tenants. In the final analysis, both landowner and tenant need to exercise reasonable care.

Liability insurance is a business necessity. The farm lease should clearly specify the party responsible for obtaining and maintaining insurance, including premises liability, building and equipment casualty, and losses of both growing and stored crops, and at what level each should be insured. Often, the landowner requires evidence of the tenant's insurance

coverage and that those policies "indemnify" the landowner for any losses he or she might suffer. By the terms of the lease, a failure to carry such coverage would most often be considered a default and grounds for termination. The lease may also require the landowner to use insurance proceeds to rebuild in the event that a structure essential to the farming operation is destroyed by fire or other casualty loss.

Recreational Uses and Liability

Vermont limits liability for landowners or tenants who make their land, streams and ponds available to the public for recreational uses. As long as the landowner doesn't charge for recreational uses, their duty to land users is no greater than that owed to a trespasser. In



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other words, the landowner owes no duty at all except to avoid willful or wanton misconduct.²⁹

The liability shield, however, does not extend to equipment, machinery, or structures unless the

recreational user does not have actual permission to use the equipment or structures.

Landowner Liability in Vermont

Business Invitees

A “business invitee” is a person invited or permitted to enter or remain on the land for a purpose directly or indirectly connected with business dealings.²⁵ Customers of a farm stand, farm suppliers, and members picking up their CSA shares are all “business invitees.” Landowners have a duty to keep the premises free from unreasonable risks to business invitees. The premises must be kept in a safe and suitable condition so that a

business invitee is not “unnecessarily or unreasonably exposed to danger.”²⁶ This is the highest standard of care imposed under Vermont law.

A Social Invitee

A “social guest” is one who enters or remains on land with the consent of the landowner. A landowner will be liable to a social guest only when the guest suffers injury as a result of active or affirmative negligence.²⁷

Trespasser

A “trespasser” is one who enters or remains on land without consent or other privilege. In Vermont, a landowner or lessee generally owes no duty of care to a trespasser, except to avoid willful or wanton misconduct.²⁸ Vermont has also not recognized the attractive nuisance doctrine, meaning that no special duties are owed to trespassing children.

Crop and Creditor’s Liens

In the case of nonpayment of rent, many states have statutes that provide the landowner an automatic lien on a tenant’s crop. In Vermont, however, there is no statutory lien for landlords. A crop is the personal property of the tenant and the landlord has no interest or right to the crop for non-payment of rent. To obtain a lien, the lease

must explicitly reserve one. A landlord without a consensual lien in the lease has no right to seize property of the tenant, to sell it, or to hold it as security for unpaid rent. In the absence of a lien, the remedy for unpaid rent is to go to court for an ejectment and a judgment for the amount of rent in arrears. Language in a lease that provides

that a crop is not to be sold or removed until the rent is paid is inadequate to give a landlord title or a security interest. The language must specifically grant a lien, and the landlord would be wise to file a financing statement with the Vermont Secretary of State’s Office putting others on notice of the lien.



Default Provisions in a Lease

A lease should spell out what constitutes default and the consequences of default on the part of either the tenant or the landowner. Default means that one of the parties to the lease has violated a term, either by failing to do something or by doing something not permitted by the lease.

Default provisions typically trigger a process that allows the landowner or the tenant an opportunity to “cure” the default within a particular time frame. For example, a tenant who misses a rental payment is given notice and a thirty-day period to make the payment.

Typical defaults under a lease involve failure to pay rent, failure to maintain liability or casualty insurance, or failure to comply with state and lo-

cal regulations. Default may also involve failure to keep the property in good repair or engaging in a use prohibited by the lease.

A lease may provide several options for dealing with a default. It may allow the landowner to draw from a pre-paid deposit or to bill the tenant for hiring someone to do the work or repair the problem. The lease may also provide that if the problem persists, the landowner may give notice of intent not to renew the lease or terminate it.

A landowner may also default under a lease. For example, a landowner’s failure to meet obligations under the lease with respect to repairs and maintenance is a default. In the case of landowner default, the lease may give the tenant

the right to withhold rent or to pay the cost of providing the repair and deduct that cost from the rent. And again, if the problem persists, the lease may allow the tenant to give notice of intent to terminate.

A lease may also include a dispute resolution process to be followed in the event of a default. Mandated dispute resolution approaches may range from a shared commitment to negotiate differences at regular meetings between the parties to a more formal mediation or arbitration process. Because of the time and expense associated with contract disputes, most commercial leases now contain a clause to allow the parties to mediate the dispute prior to litigation.

Eviction and Ejectment

Landlords in Vermont may not enter and forcibly remove a tenant who has failed to pay rent or who has stayed beyond the lease term. A landlord who does so – it’s called “entry or detainer with force” – may be held liable for restitution,

court costs, fines, and treble, or triple, damages.³⁰ If the tenant fails to pay rent or refuses to peaceably leave the premises, the appropriate course for a landowner is to go to court to seek an ejectment. A court may issue a “writ of pos-

session,” an order to pay rent into the court. Landlords may also obtain a judgment for damages and costs including attorney’s fees if the lease provides that attorney’s fees are to be paid by the losing party.³¹



CHAPTER III

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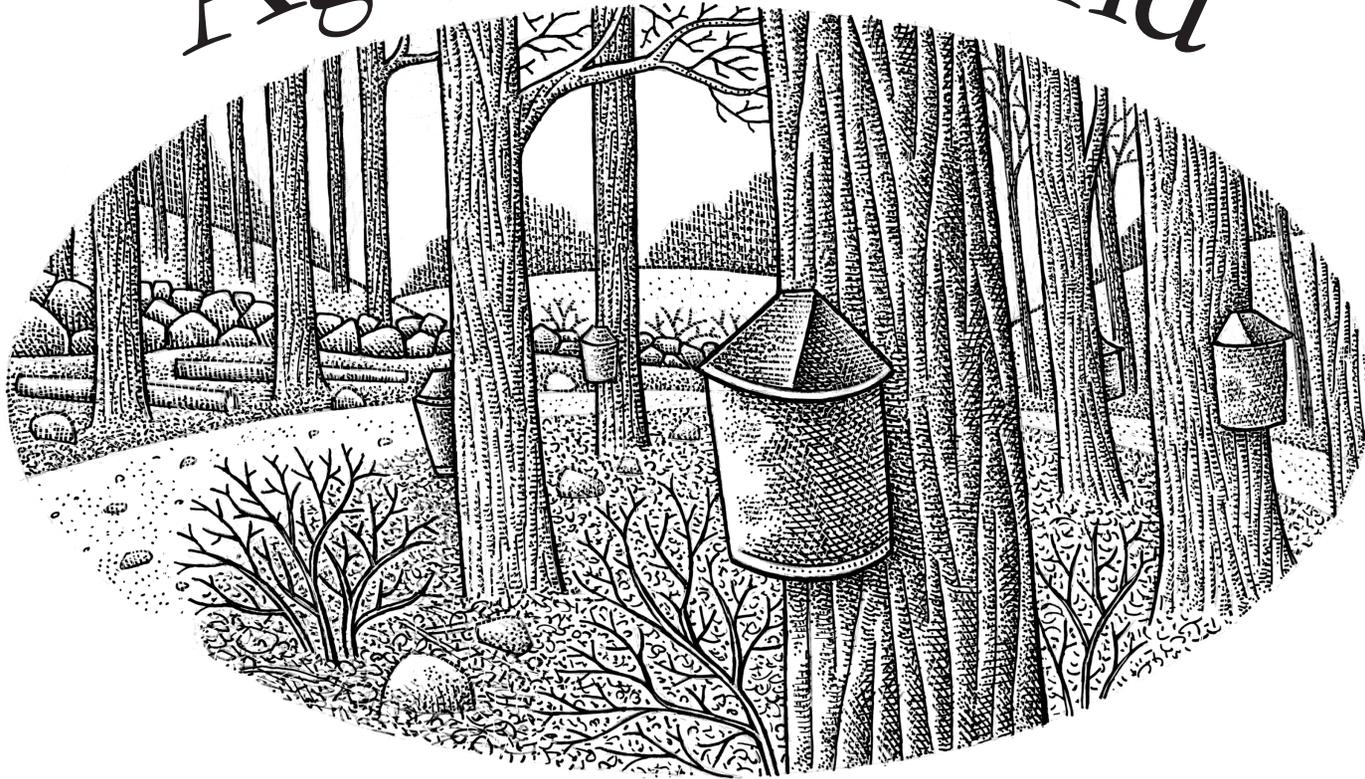
Recording of Leases

Vermont's real estate conveyance statutes require that leases be signed by the Lessor and by one or more witnesses and be "acknowledged" by the Lessor before a town clerk or a notary public.³² An acknowledgement is a statement at the bottom of the document in which the person signing acknowledges before a notary public that signing the docu-

ment is his or her "free act and deed." A copy of the lease, or if the lease is for a term of more than one year, a memorandum of the lease, must be filed in the land records of the town in which the property is situated.³³ The memorandum of lease must provide the names of the parties, the lease term, renewal rights, if any, and other summary informa-

tion. The memorandum of lease puts third parties — potential purchasers, for example— on notice that others have rights in the property. The lease will have no effect against anyone but the Lessor unless it is properly acknowledged and recorded.³⁴ **See Appendix for Sample Lease Agreement (page 154) and Memorandum of Lease (page 160).**

Agriculture and



Land Use Regulation

By Annette Higby and Sandy Levine



Nuisance or a Right to Farm?

What is a Nuisance?

A nuisance is an activity that interferes with another person's ability to use and enjoy their property. This interference must be both unreasonable and substantial. In Vermont, the courts use a "community standard" to determine whether the interference is substantial – they decide this based on a judgment of whether the interference would create offense, inconvenience, or annoyance for a normal member of the community.¹ Depending on the facts, Vermont courts have ordered a range of remedies in nuisance suits including awards of damages for neighbors as well as prohibiting those activities in cases of substantial interference.

Courts are more likely to find an interference to be "unreasonable" when the conduct is malicious or is reasonably and or inexpensively avoidable. The outcome of nuisance cases always turns on a close consideration of the facts. Courts look at all the surrounding circumstances. The magnitude, frequency, or duration of an activity as well as the manner, place, and circumstances of the offending land use are all considered.

Some courts take a second analytical step in nuisance cases. They have interpreted the "unreasonable interference" requirement to mean that they must balance the "social utility" of the complained-of activity with the annoyance that it causes the neighbors. Courts who "balance the

equities" in this way consider the social good or the general public or economic good that may be derived from the activity and weigh it against the harm done to neighbors.² This is the modern trend in nuisance cases and it most often favors the nuisance, although this is not always true. This trend favors economic development over individual property rights. Vermont courts have not adopted this second step – and may never do so.

There are three kinds of nuisances. A private nuisance substantially and unreasonably interferes with a neighbor's personal use and enjoyment of his or her property. A public nuisance is an activity that is likely to affect all the residents of the neighborhood and may involve a potential threat to the public's health and safety. A public nuisance may affect a resource, such as air or water, which everyone uses. It is an interference that affects the rights of more than just an individual neighbor. A mixed nuisance is an activity that can be characterized as both a public and a private nuisance.

Farm activities have been the subject of successful nuisance suits in at least three situations in Vermont. In one instance, neighboring dairy farmers brought suit against the Vermont Egg Farm in Highgate. The farmers complained that the flies from the 100,000 hen operation created an unreasonable interference with their own farming operations and the use and enjoyment of their land. The fly infestation attributed to the poultry operation was so severe that it

affected the neighbors' milk production and herd health and resulted in a \$50,000 jury award. In the second instance, neighbors sued over the operation of a pig farm in Stowe. The Court found that the operators used the pretext of operating a farm to intentionally annoy, upset, and harass the neighbors who opposed the operator's plans to develop a hotel on the property. The operator's activities were found to be malicious and well beyond the reasonable agricultural activities that would be shielded from nuisance lawsuits.³ The third situation involved expansion of operations at an apple orchard. The orchard's addition of shipping and storage operations interfered with the neighboring home owner. The home owner complained of excessive noise and lights from the packing operations and trucks as well as pesticides and polluted water flowing onto the neighbor's property.⁴ This case resulted in a modification to Vermont's Right-to-Farm law.

Right-to-Farm Laws

"Right-to-Farm" laws exist in most states. Generally, they put into statute a general common law defense to a nuisance claim known as "coming to the nuisance." Property owners who "move to the nuisance" may not complain when a neighboring, pre-existing use causes offense. Most "Right-to-Farm" statutes are intended to protect existing farm operations from suburban encroachment.



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They seek to slow the rate of farm land lost to development by favoring agricultural uses over the sensibilities of the new neighbors. Most statutes also require that farms adhere to all state and local regulations in order to receive the benefit of

the statute. Vermont's Right-to-Farm law, for example, requires that farmers be in compliance with accepted agricultural practices, and other state and federal regulations, or the statute will not apply. It provides a very thin shield against nuisance claims

that might be brought by neighbors because of noise, dust, odors, and other inconveniences that may result from farming operations.⁵

Vermont's right-to-farm law was revised in 2004 as a result of the Trickett case. In Trickett, the defendant

Vermont's Right-to-Farm Law

Legislative Findings and Purpose

The legislature finds that agricultural production is a major contributor to the state's economy; that agricultural lands constitute unique and irreplaceable resources of statewide importance; that the continuation of existing and the initiation of new agricultural activities preserve the landscape and environmental resources of the state, contribute to the increase of tourism, and further the economic welfare and self-sufficiency of the people of the state; and that the encouragement, development, improvement, and preservation of agriculture will result in a general benefit to the health and welfare of the people of the state. In order for the agricultural industry to survive in this state, farms will likely change, adopt new technologies, and diversify into new products, which for some farms will mean increasing in size. The legislature finds that agricultural activities are potentially subject to lawsuits based on the theory of nuisance, and that these suits encourage and could force the premature removal of the farm lands and other farm resources from agricultural use. It is the purpose of this chapter to protect reasonable agricultural activities conducted on the farm from nuisance lawsuits.

Definitions

For the purpose of this chapter, "agricultural activity" means, but is not limited to: (1) the cultivation or other use of land for producing food, fiber, Christmas trees, maple sap, or horticultural and orchard crops; the raising, feeding, or management of domestic animals as defined in section 1151 of Title 6, or bees; the operation of greenhouses; the production of maple syrup; the on-site storage, preparation, and sale of agricultural products principally produced on the farm; and the on-site production of fuel or power from agricultural products or wastes principally produced on the farm; (2) the preparation, tilling, fertilization, planting, protection, irrigation, and harvesting of crops; the composting of material principally produced by the farm or to be used at least in part on the farm; the ditching and subsurface drainage of farm fields and the construction of farm ponds; the handling of livestock wastes and byproducts; and the on-site storage and application of agricultural inputs, including but not limited to lime, fertilizer, and pesticides.

Agricultural Activities Protected from Nuisance Lawsuits

Agricultural activities shall be entitled to a rebuttable presumption that the activity does not constitute a nuisance if the agricultural activity meets all of the following conditions:

- it is conducted in conformity with federal, state, and local laws and regulations (including accepted agricultural practices);
- it is consistent with good agricultural practices;
- it is established prior to surrounding nonagricultural activities; and
- it has not significantly changed since the commencement of the prior surrounding nonagricultural activity.

The presumption that the agricultural activity does not constitute a nuisance may be rebutted by a showing that the activity has a substantial adverse effect on health, safety, or welfare or has a noxious and significant interference with the use and enjoyment of the neighboring property. Nothing in this section shall be construed to limit the authority of state or local boards of health to abate nuisances affecting the public health.



farmers, the Ochs, argued that the activities of their apple packing and storage operations were shielded by the Right-to-Farm Statute. The Vermont Supreme Court held that because the neighboring home owners lived there prior to the expansion of these operations—and in fact were living in the old farm homestead purchased from the Ochs—the Right-to-Farm law did not apply. The Tricketts hadn't moved to the nuisance. The nuisance arose after they purchased the farmstead. The Court also seemed swayed by the fact that some of the activities causing offense were easily avoidable and there appeared to be an abundance of malice on both sides.

The new Right-to-Farm law in Vermont provides farmers with a “rebuttable presumption” that certain agricultural activities are not a nuisance. A rebuttable presumption is nothing more than an evidentiary presumption. The presumption—in this case that there is no nuisance—stands until proven otherwise by the party bringing suit. Under the Vermont statute, the presumption can be rebutted by a showing that the activity “has a substantial adverse effect on health, safety, or welfare, or has a noxious and significant interference with the use and enjoyment of the neighboring property.” This standard of a “noxious and significant interference” is quite similar to the common law standard for establishing a nuisance—it requires a showing that the activity causes an “unreasonable and substantial interference” with the use and enjoyment of neighboring property. Until a court considers this aspect of the new statute, it won't

be clear whether that statutory standard imposes a higher bar for plaintiffs.

Under Vermont's prior Right to Farm law, a neighbor could overcome the presumption only on a showing that the activities had a substantial adverse effect on the public health and safety or, in effect, that the offensive activity rose to the level of a public nuisance rather than merely a private nuisance. In this respect, the new law significantly lowers the bar for plaintiffs by requiring only a showing of either a public or private nuisance.

To have the “benefit” of the rebuttable presumption, the activity complained of must meet certain conditions, as follows:

- The activity must be carried out in a manner that complies with federal, state, and local laws and regulations, including Vermont's accepted agricultural practices.
- The activity must be consistent with good agricultural practices.
- The complained-of activity must have been there first.
- The complained-of activity must not have “significantly changed” since the non-farming neighbors moved there.

Vermont farmers hope this new statute will pro-

“**T**he new Right-to-Farm law in Vermont provides farmers with a “rebuttable presumption” that certain agricultural activities are not a nuisance.



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vide some protection from nuisance suits for activities related to farm expansion or changes in farming technologies that can produce significant conflicts with neighbors. Many states have enacted provisions that attempt to protect farmers from complaints related to farm expansion and changes in farm technology and scale. These provisions extend the common law doctrine significantly. There is, to date, not enough case law in Vermont or nationally to indicate whether courts will ultimately uphold these provisions.

There are constitutional constraints on a State's

capacity to shield farmers entirely from nuisance suits.⁶ In 1998, the Iowa Supreme Court held that an Iowa statute that granted complete immunity from nuisance suits for farms in areas designated as an "agricultural area" by the County Board of Commissioners violated the U.S. and Iowa Constitutions. The Court held that immunity from nuisance suits amounted to granting the farms an easement over their neighbor's property. This was a taking of private property for public use without just compensation and was unconstitutional.

The emphasis in Vermont's Right to Farm law

on neighboring "non-agricultural uses" calls into question its applicability to conflicts between farmers. The presumption only applies when the offending use was there prior to the "surrounding nonagricultural activities" and the use has not significantly changed. The statute's focus on conflicts resulting from urbanizing encroachment calls into question its applicability to farmer vs. farmer land use conflicts such as, for example, in the Highgate Egg Farm case, when flies from the poultry operation interfered with neighboring farming operations.

Farmer-to-Farmer Conflicts over Genetically Modified Organisms

Private or public nuisance is also a potential theory of liability for damages resulting from the drift of pollen from genetically modified organisms (GMO) and pesticides. Drift potential varies by crop—more likely for corn and canola—not likely for soybeans. A number of cases still in litigation in the United States and Canada have put forth theories of liability ranging from trespass and nuisance to negligence.⁷ In most cases, the affected farmers are suing seed manufacturers rather than neighbors.

As already noted, Vermont's Right to Farm law with its emphasis on interference with neighboring non-farm uses would appear to be inapplicable to nuisance actions for damage to farm crops due to pollen drift. A neighboring farmer, however,

would still need to establish that the interference resulting from pollen drift was both substantial and unreasonable. Many commentators believe that as planting GMO crops becomes more and more common, it is less and less likely that a court would consider planting a GMO crop an "unreasonable" farm practice.

Regulating Genetically Modified Seed

Vermont is the first state in the United States to require the labeling of genetically modified seeds. The manufacturer or processor of seed containing genetically engineered material is required to label each container of seeds sold in Vermont.⁸ The

label must specify the identity and relevant traits or characteristics of the seed and any requirements for their safe handling, storage, transport, and use. It shall also provide the contact point for further information and, as appropriate, the name and address of the manufacturer, distributor, or supplier of such seed.⁹

The manufacturer or processor distributing seeds sold in Vermont that contain genetically engineered material is also required to report annually to the secretary of agriculture regarding sales of such seed during the previous year.¹⁰

In the past few years, there have been a number of proposals to further regulate and manage the use of GE seeds and other genetically modified organisms (GMOs). Currently, no further regulation



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is in place beyond labeling and reporting for GE seeds. Each time further regulation has been proposed, concerns have been raised about the constitutionality of such proposals. Both federal law and the United States Constitution will likely present some limits on how much states can regulate the use and sale of GMOs. States have broad powers to

pass laws that manage or affect the health and safety of their citizens. States, however, cannot pass laws that place unreasonable burdens on the commerce of goods and services between states or restrict free speech. For example, a Vermont law requiring the labeling of milk with BST, a bovine growth hormone, was not allowed because it was judged to be

Drainage Conflicts and Nuisance

Most disputes over drainage that end up in court are decided as nuisance or trespass cases. In Vermont, property owners have certain reciprocal rights and duties with respect to the drainage of surface waters. The upper owner has a right to have the water pass to the lower property in its natural condition, and the lower property owner has a duty to accept the natural flow of the waters upon his land.¹² Interference with the natural flow by either land owner can become a nuisance. Changing the natural flow in a way that harms the neighbor's use and enjoyment of his or her land may lead to liability in a nuisance suit.

a violation of free speech. However, a law requiring the labeling of products, such as lightbulbs, that contain mercury is allowed as a state regulation of a dangerous product—mercury.

Defining Genetically Engineered Seed

Vermont law defines “genetically engineered (GE) seed” and “genetically engineered plant part.”¹¹ A “genetically engineered (GE) seed” means seed produced using a variety of methods, as identified by the National Organic Program of the U.S. Department of Agriculture, used to genetically modify organisms or influence their growth and development

by means that are not possible under natural conditions or processes. Such methods include cell fusion, micro-encapsulation and macro-encapsulation, and recombinant DNA technology, including gene deletion, gene doubling, introducing a foreign gene, and changing the positions of genes when achieved by recombinant DNA technology. Such methods

do not include the use of traditional breeding, conjugation, fermentation, hybridization, in vitro fertilization, or tissue culture.

A “genetically engineered plant part” means a whole plant or plant part intended for planting which contains material derived from a GE seed or that was produced using the methods described above.

Agricultural Activities Exempt from Local Zoning

Vermont law prohibits municipalities from regulating “accepted agricultural practices” through zoning.¹³ There are 11 accepted agricultural practices that state law puts beyond the reach of local zoning:

- The confinement, feeding, fencing, and watering of livestock.
- The storage and handling of livestock wastes

and by-products.

- The collection of maple sap and production of maple syrup.



- The preparation, tilling, fertilization, planting, protection, irrigation and harvesting of crops.
- The ditching and subsurface drainage of farm fields and the construction of farm ponds.
- The stabilization of farm field streambanks.
- The construction and maintenance of farm structures and farm roads.
- The on-site production of fuel or power from agricultural products or wastes produced on the farm.
- The on-site storage, preparation and sale of agricultural products principally produced on the farm.
- The on-site storage of agricultural inputs including, but not limited to, lime, fertilizer and pesticides.
- The handling of livestock mortalities.

The list of agricultural activities excluded from local zoning is broad enough to include activities related to adding value to products produced on the farm, such as cheesemaking or producing jams and jellies. “Farming” includes the “on-site storage, preparation, and sale of agricultural products principally produced on the farm.” It also includes

“Farm seekers may wish to look at local zoning as a reflection of how friendly a community is towards farmers.”

activities related to the sale of farm products, such as selling from a farm stand, provided the products being sold were produced principally on the farm. The Agency of Agriculture takes the position that on-farm sales or on-farm processing and sale are within the zoning exemption if at least 51 percent of the agricultural products sold or used to make the product come from the farm.

While many agricultural activities are beyond the reach of municipalities, this zoning exemption does not shield farmers from nuisance suits. See, “What is a Nuisance?” on page 82.

Vermont law does allow towns to use zoning to protect agricultural uses. Towns may establish agricultural zoning districts that make agriculture the primary permitted use and prohibit other development except low-density residential development. For forestry districts, residential development can be prohibited.¹⁴ Towns may not, however, “zone out” farming.

Farm seekers may wish to look at local zoning as a reflection of how friendly a community is towards farmers. While farming is broadly allowed in any district, communities that specifically identify areas where farming will be the primary use, provide only low-density neighboring development, and guide that development to areas that will not conflict or interfere with farming uses are preferable to most farmers. Farm seekers may also want to consider areas where there is a concentration of preserved land for farming or where local policies such as tax benefits, use of conservation funds, or limiting housing or conflicting development near



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farms have been adopted to support farming.

To maintain the continued viability of farming in a community, local planning commissions should be encouraged to identify areas where farming will be the primary use. Expanding development infrastructure such as major roads, schools, sewer, and water should be discouraged in these areas. Zoning standards should allow flexibility for siting and lot sizes of any development near farmland to avoid conflicts and unnecessary division of farmland into large house lots. For example, communities can use tools such as the transfer of development rights, subdivision standards, or planned residential developments to guide development away from valuable farmland while allowing farmers to maintain the development value of their land.¹⁵

Construction of Farm Buildings: Siting and Setback Requirements

Vermont law also prohibits municipalities from regulating the construction of “farm structures.”¹⁶ A farm structure is a building, enclosure, or fence for housing livestock, raising horticultural or agronomic plants, or carrying out other “farming” activities as farming is defined under Act 250.¹⁷ It also includes structures used for activities “associated” with the accepted agricultural practices listed above. By including structures used for farming activities as defined by Act 250, the exemption thus extends to buildings used for on-site storage, preparation, and/or sale of agricultural products

produced on the farm. This includes farm stands, a cheese house, or another structure used for processing farm products. It also includes farm machine shops and farm equipment storage. Farm structures do not include housing for the farmer or farm employees, however.¹⁸

The definition of “farm structure” has been further defined by the Vermont Agency of Agriculture, Food and Markets as follows:

Farm Structure: a structure or structures as defined herein that is used by a person for agricultural production that meets one or more of the following:

- (a) is used in connection with the sale of \$1000 or more of agricultural products in a normal year; or
- (b) is used in connection with the raising, feeding, and management of at least the following number of adult animals: four equines; five cattle or American bison; fifteen swine; fifteen goats; fifteen sheep; fifteen fallow deer; fifteen red deer; fifty turkeys; fifty geese; one-hundred laying hens; two-hundred and fifty broilers, pheasant, Chukar partridge, or Coturnix quail; three camelids; four ratites (ostriches, rheas, and emus); thirty rabbits; one hundred ducks; or one-thousand pounds of cultured trout; or
- (c) is used by a farmer filing a 1040 (F) income tax statement with the Internal Revenue Service in at least one of the past two years; or
- (d) is on a farm with a business and farm management plan approved by the Commissioner.

While farmers do not need a local zoning permit to build a farm structure, they must notify the municipality that they intend to build one. Farmers must also abide by the setback requirements imposed by the Agency of Agriculture. The Agency has promulgated rules requiring farmers to follow the setback requirements set by the municipality. If construction is within the municipality’s setback requirements, the farmer doesn’t even have to notify the Agency of Agriculture of their intent to build. If, however, the farmer believes that the town setbacks cannot be met or are unreasonable, the farmer may submit a written request to the Secretary of Agriculture for a waiver. The written request must include a statement indicating why less restrictive setbacks are necessary; a copy of the zoning ordinance; a sketch of the planned structure; and a description of adjoining land uses.

In reviewing a request for a waiver, the Secretary will consider whether any natural physical constraints prevent compliance with the zoning ordinance; whether conformance with the ordinance will create insurmountable farm operational constraints; whether a waiver of the ordinance would create an unreasonable nuisance for the adjoining property owners; and whether the waiver will allow for the introduction of modern day technology while maintaining the character of the neighborhood.

The Secretary will notify the municipality in writing of a farmer’s request for a waiver decision in order to get the municipality’s input.



Farming and Act 250

Act 250 is a state land-use law that requires larger developments to obtain a permit before developing or subdividing land in Vermont. To obtain a permit, developments must meet ten statutory criteria addressing the environmental and community impacts of the proposed development.¹⁹

Act 250 exempts most farming activities by saying that “development” does not include: “the construction of improvements for farming, logging, or forestry purposes below the elevation of 2,500 feet.” Farming is defined broadly under Act 250.

By including “on-site storage, preparation, and sale of agricultural products principally produced on the farm” the exemption covers facilities to add value to farm produce, including cheese houses or farm stands. The Vermont Environmental Board has addressed the farming exemption in several cases and has been generous in extending the exemption to construction projects to support on-farm processing and on-farm sales of products “principally produced on the farm.”

The Vermont Environmental Board has also weighed in on the meaning of “principally produced on the farm” and decided that “if the majority of the weight or volume of the ingredients in

the finished product comes from the farm,” those activities are “farming” and are exempt.²¹ In that case, the Board also allowed a small-scale culinary school that would utilize a variety of fruits produced on the farm to develop new products and markets to be considered as “farming” and “farming activities.” The Board made it clear, however, that a culinary school on a larger scale that included a restaurant, for example, would cross over the line from farming into a commercial activity subject to regulation.

Agricultural Soils Protected by Act 250

One criteria necessary for an Act 250 permit relates to development on prime agricultural soils. Act 250 provides standards for development to avoid, or mitigate, the impacts of building on important agricultural soils. Agricultural soils are soils that have a potential for growing food and forage crops with few limitations. Natural Resources Conservation Service (NRCS) soil maps are generally used as a guide and are available from a local NRCS office.

Before development is allowed, the applicant

Farming Defined under Act 250

The definition of farming under Act 250²⁰ is as follows:

- the cultivation or other use of land for growing food, fiber, Christmas trees, maple sap, or horticultural and orchard crops; or
- the raising, feeding, or management of livestock, poultry, fish, or bees; or
- the operation of greenhouses; or
- the production of maple syrup; or
- the on-site storage, preparation, and sale of agricultural products principally produced on the farm; or
- the on-site production of fuel or power from agricultural products or wastes produced on the farm; or
- the raising, feeding, or management of four or more equines owned or boarded by the farmer including training, showing and providing instruction and lessons in riding, training and the management of equines.

CHAPTER IV



AGRICULTURE AND LAND USE REGULATION

must show that it has minimized the impact on the site's agricultural soils. This can be done by siting development in areas without agricultural soils or clustering development in a smaller area. In limited circumstances, development is allowed on agricultural soils, provided other agricultural lands are protected. This is done through the Vermont Agency of Agriculture and the Vermont Housing and Conservation Board either by permanently

protecting at least two acres of comparable agricultural lands in the vicinity of the development for every one acre that is lost to development or by paying an impact fee for "agricultural soils mitigation" that is used to protect other agricultural lands in the vicinity at the same two to one ratio.²²

The Act 250 protections for agricultural soils provide some important resources and opportunities for farming. They help target development to

areas that are less suitable for farming. They create both a financial and a regulatory incentive to avoid and minimize the amount of development on farmland. At the same time, they provide additional funding and incentives to permanently protect a community's agricultural resources and help to ensure the continued viability of local farming activities into the future.

Farm Labor



Regulation

By Annette Higby



FARM LABOR REGULATION

Overview

Like many types of regulation in agriculture, the regulation of farm labor is all about the exemptions. Some state and federal labor regulations apply to all farms regardless of size. Vermont's Fair Employment Act, which prohibits certain kinds of discrimination, the federal Immigration Reform and Control Act, which imposes penalties for knowingly hiring unauthorized workers, as well as the

state and federal laws prohibiting child labor, apply to all farms in Vermont. Other regulatory schemes, however, only apply to farms of a certain size, payroll, or number of employees. Along with farm size, the way in which a particular regulatory scheme defines agriculture is also important to whether or not you must comply. The chart below provides an overview of the major state and federal rules and regulations in ascending order

of farm or payroll size. With one notable exception, if your farm is exempt, you needn't concern yourself with those rules. The notable exception is Workers' Compensation. Employers enrolled in Workers' Compensation have immunity from employee lawsuits for job-related injury and disability. Even if you are exempt from having to provide Workers' Compensation, you may want to cover your employees anyway.

Employer Type	Must Comply with
All Agricultural Employers	The Vermont Fair Employment Act , which prohibits discrimination on the basis of race, color, religion, ancestry, national origin, sex, sexual orientation, place of birth, age, or against a qualified individual with a disability. The VFEA also mandates equal pay for equal work and prohibits sexual harassment in the work place.
All Agricultural Employers	The federal Immigration Reform and Control Act , which forbids employers from knowingly hiring or continuing to employ individuals who are not authorized to work in the United States. IRCA also requires employers to verify the citizenship or work authorization of all new hires on an Employment Eligibility Form I-9.
All Agricultural Employers	The rules regarding child labor under the Vermont and Federal Fair Labor Standards Act .
Agricultural Employers who pay cash wages of at least \$150 to an individual or a total of \$2,500 in annual cash wages	The IRS rules on withholding social security, Medicare, and federal income taxes and must pay an employer's share of FICA.



CHAPTER V
FARM LABOR REGULATION

Employer Type	Must Comply with
Agricultural Employers with 4 or more employees	The anti-discrimination provisions of the Immigration Reform and Control Act that prohibit employers from discriminating on the basis of national origin in hiring, firing, and recruiting workers.
Agricultural Employers with an aggregate payroll of \$10,000 in a calendar year	Vermont's Workers' Compensation law, although employers with an aggregate payroll of less than \$10,000 may still voluntarily opt for coverage.
Agricultural Employers who use more than 500 man days of agricultural labor (approximately 7 full time employees) in any calendar quarter during the preceding calendar year	The minimum wage requirements of the Vermont and federal Fair Labor Standards Act .
Agricultural Employers with 10 or more employees for an average of at least 30 hours per week during a year	Parental leave requirements under the Vermont Family and Medical Leave Act that require up to 12 weeks of unpaid leave for employees that have been employed for a period of one year for an average of 30 hours per week.
Agricultural Employers with 15 or more employees for an average of at least 30 hours per week during a year	Family leave requirements under the Vermont Family and Medical Leave Act that require up to 12 weeks of unpaid leave for employees that have been employed for a period of one year for an average of 30 hours per week.
Agricultural Employers who have paid cash wages of \$20,000 to individuals employed in agricultural labor, OR who employ 10 or more individuals in each of 20 calendar weeks in either the current or preceding calendar year	Vermont's Unemployment Insurance (see http://www.det.state.vt.us/sections/uiwages/).
Agricultural Employers who employed more than 10 individuals at any one time in the previous 12 months	Vermont Occupational Safety and Health Administration rules on Field Sanitation Standards that require potable water, toilets, and hand-washing facilities for field laborers, and comply with OSHA standards for roll-over protective structures, slow-moving vehicles, equipment guards, storage and handling of anhydrous ammonia, logging operations, and several other areas of safety concern on farms.



Employees vs. Independent Contractors

Employees are entitled to certain protections under state and federal law—Workers’ Compensation and Unemployment Insurance coverage, for example. Employers are responsible for withholding federal and state income taxes and must also pay a share of the employee’s social security taxes. Independent contractors, however, can be treated differently than employees. They generally carry their own insurance, pay a self-employment tax as a contribution to social security, and work somewhat independently under a contract to provide their services.

The standard used most often—under the FLSA and by the IRS—defines an employee as someone who, as a “matter of economic reality, follows the usual path of an employee and is dependent on the business which he or she serves.” The U.S. Department of Labor looks to a Supreme Court case that held that there is no single rule or test for determining when an individual is an independent contractor or an employee. The Court said that you had to look at the totality of the situation and identified some factors that they considered to be significant:

1) The extent to which the services rendered are

an integral part of the principal’s business. If the business is farming, and the individual is engaged in primary agricultural activities (tilling, cultivating, caring for livestock, harvesting, dairying, and so on), the individual is likely to be an employee rather than an independent contractor. If the business is farming and the individual is providing non-agricultural services, he or she is more likely to be an independent contractor.

- 2) The permanency of the relationship. If the individual has been providing services for many years, he or she is more likely to be an employee.
- 3) The amount of the alleged contractor’s investment in facilities and equipment. The greater the investment, the more likely it is that the individual is an independent contractor.
- 4) The nature and degree of control by the principal. If the proprietor closely directs the work, the individual is more likely to be an employee.
- 5) The alleged contractor’s opportunities for profit and loss. If the individual bears some financial

risk in the enterprise, he or she is more likely to be an independent contractor.

- 6) The amount of initiative, judgment, or foresight required and whether they are in open market competition with others. If the individual does not have to show initiative, judgment, or foresight to successfully perform the job, the more likely he or she is to be an employee.
- 7) The degree of independent business organization and operation. The greater the independence, the more likely the person is to be an independent contractor.

There are certain factors that are immaterial in determining whether there is an employment relationship. Such facts as the place where work is performed, the absence of a formal employment agreement, or whether an alleged independent contractor is licensed by State/local government are not considered to have a bearing on determinations as to whether there is an employment relationship. Additionally, the Supreme Court has held that the time or mode of pay does not control the determination of employee status.



FARM LABOR REGULATION

Immigration Reform and Control Act

The Immigration Reform and Control Act (IRCA), passed in 1986, imposes penalties upon employers who knowingly hire or knowingly continue to employ individuals who are not authorized to work in the United States. IRCA requires employers to verify the citizenship or work authorization of all new hires. This verification must take place only after the employee is hired. Once hired, the employee and employer must complete an Employment Eligibility Form I-9. An I-9 form is not necessary for independent contractors.

In Section I of the I-9 Form, employees must indicate whether they are citizens, nationals, lawful permanent residents, or work-eligible aliens. The employer completes Section II, although the employee must provide the employer with specific documentation for it. The list of documents is intended to first ensure that the individual is work-authorized and second, to verify the identity of the individual. Some documents accomplish both goals. An expired or unexpired U.S. passport, for example, establishes both work authorization and identity. An unrestricted social security card – work authorization – along with a driver's license – identity – is also acceptable. The various documents that are deemed acceptable are listed on the back of the I-9 Form.

The employee must submit originals of these

documents. Photocopies are not acceptable. The employer need only review the documents for the appearance of authenticity. If the documents appear to be authentic, the employer must accept them. If the documents do not appear to be authentic (for example, if a document appears to be altered), the employer may ask for a substitute document. If the employee is unable to present a suitable substitute document, the employer is supposed to terminate the employee or risk penalties for knowingly continuing to employ an individual not authorized to work in the United States.

Employers must retain the I-9 Form for whichever date comes later—three years after the date of hire or one year after the termination of employment.

Some resident alien cards issued by the INS have expiration dates. In some cases, even though the card has expired, the underlying status and the work authorization that goes with it has NOT expired. INS operates an employer's hotline that can help you navigate these kinds of issues. The number is: 1-800-357-2099.

Anti-discrimination Provisions of IRCA

During the IRCA debate in Congress, many immigration advocates expressed concern that penalizing

employers for hiring unauthorized workers would increase workplace discrimination. They feared that many employers would simply not hire workers who looked or sounded foreign to avoid IRCA sanctions. As a result of these concerns, Congress included provisions in IRCA which prohibit employers from discriminating on the basis of national origin in hiring, firing, and recruiting workers. These provisions are administered by the Office of Special Council for Immigration Related Unfair Employment Practices of the U.S. Department of Justice.

The anti-discrimination provisions apply to any employer with four or more employees.

The most common way to run afoul of the anti-discrimination provisions is to decide not to hire someone solely because they look or sound “foreign.” You can also violate the law if you demand additional documentation when the documents submitted by the employee appear to be authentic. For example, employers who will only accept a green card and no other document listed on the I-9 form are violating the anti-discrimination provisions. In addition, employers may not ask job applicants where they were born or whether they are authorized to work in the United States during the interview process. Verification of work authorization status is to take place after hiring, during completion of the I-9 Form.



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Employees and the Tax Man

Agricultural employers who pay cash wages of at least \$150 to an individual employee in the course of a year must withhold for that employee. Employers who pay a total of \$2,500 in annual cash wages to all their employees must also withhold social security, Medicare, and federal income taxes.

Employers must also pay a share of an employee's social security (6.2%) and Medicare (1.45%) taxes. You can find a wealth of information on your responsibility to withhold federal income tax and pay social security and Medicare taxes for your employees in the "Agricultural Employer's Tax

Guide," published by the IRS. You can find it on the web at: <http://www.irs.gov/pub/irs-pdf/p51.pdf>. This publication also includes information on the advanced earned income credit, the federal unemployment tax act, recordkeeping responsibilities, and wage reporting forms.

Employee Compensation

Agriculture under the Fair Labor Standards Act

The federal Fair Labor Standards Act¹ (FLSA) governs minimum wages, overtime pay, and rules prohibiting oppressive child labor. The state of Vermont has also adopted legislation governing minimum wages, overtime pay, and child labor.² Both the FLSA and the State of Vermont exempt certain agricultural activities from the minimum wage, overtime, and child labor rules.

While Vermont has adopted many of the federal rules and definitions, there are some differences. Whichever rule sets the higher standard or provides a higher level of worker protection is the rule that applies. Vermont, for example, has set \$7.25 as a minimum hourly wage beginning January 1, 2006 and is one of just thirteen states that sets a rate higher than the \$5.15 federal minimum wage.

Beginning in 2007 the Vermont minimum wage will increase by either 5 percent or by the percentage increase in the Consumer Price Index, whichever is smaller.³

The FLSA uses a two-pronged definition of agriculture that includes both primary agricultural activities as well as those activities that are secondary or incidental to carrying out the farming operation. The primary definition includes "farming in all of its branches" – cultivation and tillage, dairying, growing and harvesting horticultural crops, raising livestock, bees, fur-bearing animals, and poultry.⁴ Anyone performing these activities is engaged in agriculture regardless of whether he or she is employed by a farmer or on a farm.

Agriculture—and thus the exemption—also includes activities that are secondary to the farming operation. Those activities must be performed by a farmer on a farm "as an incident to or in con-

junction with such farming operations" to be considered "agriculture." For example, employees who build a silo or a terrace, or those who dig a stock well, are exempt when those activities are performed in conjunction with a farming operation. Logging activities, for example, are also exempt when they are part of a farming operation. But when these employees work for an employer engaged exclusively in forestry or lumbering, they are not considered agricultural employees.

These secondary activities must be subordinate to the farming operation. If they amount to a separate business, they lose the agricultural exemption. Building grain storage facilities to store grain produced by other farmers or on other farms, for example, would not be exempt. Likewise, the operation of a gravel pit for selling gravel off the farm is probably not exempt. But when an employee removes gravel for on-farm use, that activity is in-



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cidental to and part of the farming operation.

Exempt activities on a dairy farm would include separating cream, bottling milk and cream, and making butter or cheese when the farmer or employee of the farmer uses milk produced by that farmer on that farm. But if the milk was produced on another farm, these activities are not exempt.

Similarly, employees engaged in cleaning, grading, preserving, packing, and processing fruits and vegetables on a produce farm are exempt employees unless they are processing fruits or vegetables produced by another farmer or on another farm.

Secondary activities also include “delivery to storage or to market or to carriers for transportation to market” when performed by a farmer or his employee as an incident to his own farming operations.

Minimum Wage and Overtime Pay Exemption

Both Vermont and federal FLSA exempt agriculture from the overtime pay requirements. Vermont, in fact, excludes any individual employed in agriculture from both the overtime and the minimum wage requirements.⁵ Remember, however, that the law that provides the greatest protections for workers will always apply. In this case it is the more limited federal exemption from the minimum wage that will apply to agricultural workers in Vermont. For those agricultural employees that fall outside the federal exemption, the applicable minimum wage rate is the more generous one set

by Vermont’s rules – \$7.25 an hour.

The federal Fair Labor Standards Act exempts several kinds of agricultural employees from the minimum wage. They include:

1. Any employee who is a parent, spouse, child, step-child, or other member of the farmer’s immediate family.
2. Any employee working for an employer who did not use more than 500 man days of agricultural labor during any calendar quarter during the preceding calendar year. For the purposes of this exemption, a man day is defined as any day in which an employee performs any agricultural labor for not less than 1 hour. 500 man days in any calendar quarter is “approximately the equivalent of seven employees employed full time in a calendar quarter.”⁶ Employers who own several farms or other enterprises must count all employees engaged in agricultural activities toward the 500 man-day limit. The test only applies to the preceding year.
3. There is also an exemption from the minimum wage and overtime pay requirements for local, temporary workers who perform hand-harvesting on a piece-rate basis. For more on this exemption, see the DOL interpretive bulletin at 29 CFR §780.319. This is one of several specialized exemptions for labor-intensive and seasonal farming activities.

4. There is also a special exemption from the overtime pay provisions for employees engaged in maple syrup production. See 13(b)(15) of FLSA and §780.816.

Interns under the Fair Labor Standards Act

A farm internship can provide valuable on-farm experience for a farm-seeker. Farm experience is essential to successful credit applications and other opportunities available to farm-seekers. Most farm internships, however, involve long hours and little or no pay. The Wage and Hour Division of the Department of Labor has developed a six-part test to determine when an intern is an “employee” under the Act. If an intern is an “employee,” an employer must count them in determining whether they use more than 500 man days of agricultural labor. If the employer falls outside the agricultural or other exemption, the employee/intern is entitled to the minimum wage and other protections afforded under the FLSA. **The six-part test is as follows:**

1. The training, even though it includes actual operation of the facilities of the employer, is similar to that which would be given in a vocational school.
2. The training is for the benefit of the trainees or students.



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3. The trainees or students do not displace regular employees, but work under their close supervision.
4. The employer that provides the training derives no immediate advantage from the activities of the trainees or students, and on occasion his/her operations may actually be impeded.
5. The trainees or students are not necessarily entitled to a job at the conclusion of the training period.
6. The employer and the trainees or students understand that the trainees or student are not entitled to wages for the time spent in training.

In applying this test, some courts have required

that all six factors be met. Other courts have looked to the totality of the circumstances and found the trainee was not an employee even where one of the factors was missing.⁷ In most farm internship situations, the employer derives an immediate benefit from the efforts of the intern and therefore most farm interns are arguably covered under the FLSA. The law, however, does not appear to be universally enforced. Unpaid internships have become a widespread and accepted rite of passage for many professions in our economy, including law, agriculture, and media.

Volunteers are exempt from the minimum wage and overtime pay requirements of the FLSA. An individual who, “without promise or expectation of compensation, but solely for his personal pur-

pose or pleasure, worked in activities carried on by other persons either for their pleasure or profit, is outside the sweep of the Act.”⁹

Neighboring Regulations

In a case where neighboring farmers exchange their own work under an arrangement where the work of one farmer is repaid by the labor of the other farmer and there is no monetary compensation for these services paid or contemplated, the Department of Labor would not assert that either farmer is an employee of the other.”⁸

Child Labor Regulations

Vermont issued comprehensive child labor regulations in 2003.¹⁰ These rules adopt many of the standards and restrictions of the federal FLSA. They also provide some additional protections for Vermont minors employed in Agriculture.

Employing Minor Non-Family Members

Youth employed on Vermont farms must be at least 16 years of age when:

- The work hours are during school hours for the school district in which the child lives, or
- The work involves certain farm activities deemed by the Secretary of Labor to be particularly hazardous. (See “Prohibited Activities by Young Farm Workers,” page 99.)
- Youth at least 14 to 16 years of age may work outside of school hours.

Youth 12 to 13 years of age may work outside of school hours only:

- with the written consent of their parent, or
- if they are working with a parent who is also employed on the farm.

Youth under 12 may:

- be employed by their parents on their parents’ farm, or
- be employed with parental consent on a “small farm” defined as exempt from the minimum wage provisions. (The 500 man-day rule.)



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Prohibited Activities by Young Farm Workers

Unless employed by a parent on a farm owned or operated by such parent, the following activities are deemed particularly hazardous for children below the age of 16 and are prohibited:

- Operating a tractor of over 20 PTO horsepower or connecting or disconnecting an implement or any of its parts to or from such a tractor.
- Operating or assisting to operate, including starting, stopping, adjusting, feeding, or any other activity involving physical contact associated with the operation, of any of the following machines:
 - (i) Corn picker, cotton picker, grain combine, hay mower, forage harvester, hay baler, potato digger, or mobile pea viner;
 - (ii) Feed grinder, crop dryer, forage blower, auger conveyor, or the unloading mechanism of a non-gravity-type self-unloading wagon or trailer; or
 - (iii) Power post-hole digger, power post driver, or non-walking type rotary tiller.
- Operating or assisting to operate, including starting, stopping, adjusting, feeding, or any other activity involving physical contact associated with the operation, any of the following machines:
 - (i) Trencher or earthmoving equipment;
 - (ii) Fork lift;
 - (iii) Potato combine; or
 - (iv) Power-driven circular, band, or chain saw.
- Working on a farm in a yard, pen, or stall occupied by a:
 - (i) Bull, boar, or stud horse maintained for breeding purposes; or
 - (ii) Sow with suckling pigs or cow with newborn calf with umbilical cord present.
- Felling, bucking, skidding, loading, or unloading timber with a butt diameter of more than 6 inches.
- Working from a ladder or scaffold and painting, repairing, or building structures, pruning trees, picking fruit, and so on at a height of over 20 feet.
- Driving a bus, truck, or automobile when it is transporting passengers or riding on a tractor as a passenger or helper.
- Working inside:
 - (i) A fruit, forage, or grain storage designed to retain an oxygen-deficient or toxic atmosphere;
 - (ii) An upright silo within 2 weeks after silage has been added or when a top unloading device is in operating position;
 - (iii) A manure pit; or
 - (iv) A horizontal silo while operating a tractor for packing purposes.
- Handling, including cleaning or decontaminating equipment; applying, disposing, or returning empty containers; or serving as a flagman for aircraft applying agricultural chemicals classified under the Federal Insecticide, Fungicide, and Rodenticide Act (7 U.S.C. 135 et seq.) as Category I of toxicity, identified by the word “poison” and the “skull and crossbones” on the label, or Category II of toxicity, identified by the word “warning” on the label;
- Handling or using a blasting agent, including but not limited to: dynamite, black powder, sensitized ammonium nitrate, blasting caps, and primer cord; or
- Transporting, transferring, or applying anhydrous ammonia.

There are some exemptions from the rules on hazardous agricultural activities for student learners, vocational and technical school students, and for youth that have completed training courses provided by Extension. For more information, contact the Vermont Department of Labor.



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Employing Family Members

Children younger than 16 years of age may work for their parents on a farm owned or operated by their parents at any time – inside or outside of school hours. This does not relieve the parent

of compliance with truancy laws, however. Children working for their parents on their farm may also engage in those agricultural activities deemed particularly hazardous. (See side bar, “Prohibited Activities by Young Farm Workers,” page 99.)

Minimum wage and overtime pay rules apply

in Vermont regardless of the age of the employee. If the farm is not exempt from the minimum wage, you must pay youth the minimum wage.¹¹ Violations of child labor laws can lead to fines of up to \$10,000 per offense and up to six months in jail.¹²

Foreign Workers and the H-2A Visa Program

As this section is being written, the U.S. Congress is debating immigration reform. Some of the proposals currently under discussion include a provision for a new “guest worker” program that would allow agricultural employers, including dairy farmers, to employ foreign workers for up to three years.¹³ Some of those proposals include an avenue for these guest workers to eventually become either lawful permanent residents or citizens. It’s not clear whether any of these proposals will pass either the Senate or the conference committee review. As of April, 2006, the only agricultural guest-worker program available is offered under the H-2A Visa program.

According to the 2004 Yearbook of Immigration compiled and published by the Department of Homeland Security, there were a total of 22,141 H-2A visas granted nationally in 2004. Of the total, 17,218 of the guest workers were from Mexico.

The H2A visa program allows agricultural employers to legally hire “non-immigrant” workers to

perform temporary or seasonal farm work when there is a shortage of U.S. workers who are “able, willing, qualified and available to work.” Guest-worker programs have a long and not very admirable history. H-2A is the successor to the bracero program that brought Mexican workers to labor on U.S. farms from 1942 through 1964. The bracero program was criticized for widespread abuses by employers and farm labor contractors. Substandard housing, discrimination, unsafe and substandard working conditions, and under or non-payment of wages were common complaints. The bracero program was allowed to expire in 1964, after Edward R. Murrow hosted “Harvest of Shame,” an embarrassing CBS news documentary about the life of migrant workers.

The H-2A program, which was closed to Mexican workers until the bracero program expired, was authorized under the Immigration and Naturalization Act of 1952, and further amended by the Immigration Reform and Control Act of 1986. It is

jointly administered by the Department of Labor and the Department of Justice. An employer first makes application for it to the Department of Labor. It’s possible to make this application may be made on-line at www.h2a.doleta.gov. The application must be filed no less than 45 days before the employer estimates that workers are needed. The regulations provide for an expedited review of the application by the Department of Justice. Early applications are encouraged, however.

Aliens in the United States illegally or who are here legally but are unauthorized to work are not eligible for this program. Only “non-immigrants” are eligible. “Non-immigrants” are workers who reside in another country, have no intention of staying in the United States, and intend to return to their country of origin once the temporary or seasonal work is completed. “Temporary” means less than one year, although extensions are possible in certain extreme situations. H-2A workers may only perform agricultural work, which is broadly de-



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fined to include even the processing of farm products if more than one half of the commodity being processed was produced by the farm operator.

To get an H-2A Visa, the employer petitioner must obtain a determination from the Department of Labor that:

- There are insufficient workers in the region who are able, willing, and qualified and who will be available at the time and place needed to perform the labor or services needed, and
- The employment of a foreign worker will not adversely affect the wages and working conditions of similarly employed workers in the United States.

The H-2A regulations require employers seeking H-2A workers to first actively recruit U.S. workers by placing ads in general circulation publications and other outlets. And in order to ensure that the hiring of foreign workers does not depress U.S. wages, the program requires H-2A employers to offer a minimum wage rate known as the “adverse

effect wage rate” (AEWR). This rate is determined by the Department of Labor and is tied to the annual average hourly wage rate for similar work in the region. The general agricultural labor AEWR rate in Vermont for 2006, for example, was \$9.16 an hour. Specific rates are also set for specific types of agricultural work. The 2006 AEWR for harvesting vegetables in Vermont was \$9.00 an hour. The AEWR rates can be found online at: <http://workforcesecurity.doleta.gov/foreign/adverse.asp>.

The employment benefits afforded to H-2A workers are strictly regulated by the Department of Labor.¹⁴ H-2A employers are required to provide insurance for the guest workers with coverage for workplace injury and disease at levels equal to Vermont’s Workers’ Compensation coverage. H-2A employers are also required to provide housing for guest workers as well as meals or convenient cooking facilities and in some cases, transportation to the workplace. Charges, if any, for meals are limited by the Department of Labor. Housing standards are tied to OSHA standards if housing is provided by the employer or to standards established under the State’s landlord-tenant law if the housing is rental housing. The employer must

guarantee payment to the H-2A worker for at least three-quarters of the period specified in the job offer. H-2A workers, however, are excluded from coverage under the Migrant and Seasonal Agricultural Worker Protection Act.¹⁵ An employer’s handbook on the H-2A program is available online at: <http://www.nhes.state.nh.us/alien/h2a-app.pdf>.

The H-2A program does not provide any opportunity to the guest worker to become a legal resident alien or a U.S. Citizen. The H-2A Visa is tied to the employer and once it expires, guest workers are expected to return to their country of origin.

Estimates of the number of undocumented aliens residing in the United States range from 7 to 12 million. A study by the Pew Hispanic Center suggests that there may be as many as 5.5 million unauthorized workers in the United States. The Pew Center also estimates the number of unauthorized agricultural workers at 1.2 million.¹⁶ The Department of Labor conducts a periodic survey of agricultural workers and in 2001, 53 percent of the agricultural workers surveyed were not legally authorized to work in the United States.¹⁷



The Vermont Fair Employment Practices Act

Vermont's Fair Employment Practices Act is patterned after Title VII of the federal Civil Rights Act. The standards and burdens of proof are identical to those applied under the Title VII of the U.S. Civil Rights Act. Vermont courts, however, will consider the interpretations of employment discrimination laws in other states under other state laws as well as federal case law when interpreting Vermont's law.¹⁸

Under FEPA, unless there is a bona fide occupational qualification that requires a person of a particular race, color, religion, national origin, sex, sexual orientation, ancestry, place of birth, age, or physical or mental condition, it is unlawful for ANY employer to discriminate against any individual on the basis of race, color, religion, ancestry, national origin, sex, sexual orientation, place of birth, or age or against a qualified individual with a disability.

A "qualified individual with a disability" refers to an individual with a disability who is nevertheless capable of performing the essential functions of the job or jobs for which the individual is being considered with reasonable accommodation to the disability. For example, a housekeeping worker in a Stowe tourist resort was fired because she had no upper teeth – a disability which the Vermont Supreme Court found did not affect her capacity to perform her job and therefore, found her firing was based on illegal discrimination.¹⁹ See the sec-

tion below for further information.

Discriminating on the basis of pregnancy is considered discrimination on the basis of sex. In other words, pregnancy should be treated like any other temporary disability.

It is illegal to discriminate on the basis of a person having a positive test result from an HIV-related blood test. It is also illegal to request or require an applicant or prospective employee to have an HIV-related blood test as a condition of employment.

Burden of showing a bona fide occupational qualification – that the job requires a particular sex or nationality, for example – is on the employer. Such qualifications are rarely upheld.

It is also illegal to indicate a preference, limitation, specification, or discrimination based upon race, color, religion, ancestry, national origin, sex, sexual orientation, place of birth or age or against a qualified individual with a disability in an advertisement for employees.²⁰ You can, however, indicate that the job requires heavy lifting, work with large livestock, or other essential tasks.

Vermonters with Disabilities

The federal Americans with Disabilities Act prohibits²¹ discrimination against individuals with disabilities in employment, housing, public accommodations, education, transportation, com-

munication, recreation, institutionalization, health services, voting, and access to public services. The employment-related provisions of the federal legislation only apply to employers with 15 or more employees on each working day in each of 20 or more calendar weeks in the current or preceding calendar year.

Vermont law regarding employment discrimination against disabled but otherwise qualified employees is based on the federal legislation and federal case law and regulations are used as guidelines for interpreting the meaning of the laws. Unlike the federal law, however, the Vermont law applies to any employer of one or more employees.²²

The law in Vermont seeks to protect disabled individuals with physical or mental impairments that substantially limit one or more major life activities. Our attitudes about certain disabilities also play a role in defining what is and is not "substantially limiting." Vermont law seeks to protect individuals who are regarded by their employer as having such impairment.²³

The definition of disability is broad. It can include physiological disorders or conditions, cosmetic disfigurement, anatomical loss, as well as mental or psychological disorders. It does not, however, include alcoholism or drug addiction.

The law prohibits employment discrimination against disabled individuals who are otherwise capable of performing the essential functions of the



FARM LABOR REGULATION

job with reasonable accommodation. These two factors are linked; if an individual is unable to perform the job but could do so with reasonable accommodation, the law requires accommodation.

Reasonable accommodation may involve changes and modifications that can be made in the structure of a job or in the manner in which a job is performed unless it would impose an undue hardship on the employer, given:

- the size of the employer's operation, the number of employees, the number and type of facilities, the size of the budget, and
- the cost of the accommodation.

For example, where reasonable, the law imposes an obligation to make facilities used by all employees, such as hallways, restrooms, and cafeterias, accessible and usable. Depending on the capacity of the employer to make accommodations, it may also

require job restructuring, part-time or modified work schedules, and the acquisition or modification of equipment or devices.²⁴

Equal Pay for Equal Work

Vermont's FEPA also prohibits any employer from discriminating between employees on the basis of sex by paying wages to employees of one sex at a rate less than the rate paid to employees of the other sex for equal work that requires equal skill, effort, and responsibility that is performed under similar working conditions.²⁵

Sexual Harassment

Sexual harassment is a form of sex discrimination and it is a violation of both the Vermont FEPA and the Federal Civil Right Act. In Vermont, sexual harassment can entail direct and

specific harassment involving unwanted sexual advances or inappropriate and offensive touching or more generally, a workplace that becomes a hostile work environment.²⁶ Courts are more likely to find a "hostile work environment" when women are subjected to lewd and sexually suggestive remarks; displays in common areas of sexually oriented materials that tend to denigrate women; vulgar and derogatory remarks about the employee's appearance; and when women are judged differently and more harshly than male colleagues.

Serious Consequences

Violating the FEPA can be very expensive. It can result in civil penalties, getting stuck with the costs of the State's investigation, restitution of lost wages and benefits, punitive damages, and payment of the employee's attorney's fees.²⁷



FARM LABOR REGULATION

Workplace Safety and Working Conditions

EPA Worker Protection Standards

The federal Environmental Protection Agency under the Federal Insecticide, Fungicide and Rodenticide Act regulates worker safety standards to reduce pesticide poisoning and injury among agricultural workers. Any paid employee on a farm who handles pesticides or who cultivates or harvests plants on farms is covered by the worker protection standards. The standards are designed to reduce worker exposure to pesticides by imposing workplace practices and responses to accidental poisonings and emergencies. **The standards impose certain duties as follows.**

- **Application.** Employers must ensure that the handlers use the pesticide in a manner consistent with the label and without exposing other workers. Workers must have access to the labels.
- **Protective Equipment.** The regulations require employers to provide personal protective equipment for handlers.
- **Restricted entry.** Employers must ensure that all workers are excluded from the area for the period specified on the pesticide label.
- **Notification.** Employers must provide notice

to employees of areas that have been treated.

- **Decontamination.** Employers must ensure an ample supply of soap, water, and washing equipment in case of emergency contamination.
- **Training.** Employers must provide training for all handlers of pesticides.

More information about the EPA worker protection standards can be found at their website: <http://www.epa.gov/pesticides/health/worker.htm> and at the Vermont Agency of Agriculture Food and Markets website: <http://www.vermontagriculture.com/Pesticidecontrol.htm>.

Vermont Occupational Safety and Health

Vermont has adopted the federal Occupational Safety and Health Act. Its provisions are enforced by the Department of Labor and Industry, Vermont Occupational Safety and Health Administration or “VOSHA.” The federal Occupational Safety and Health Act imposes upon all employers a “general duty” to furnish to each employee a place of employment which is free from recognizable hazards that cause or are likely to cause death or serious physical harm to employees.²⁸ If you

comply with OSHA’s standards for agricultural operations, you will be deemed in compliance with the general duty clause for the condition covered by the standard.

Most agricultural operations, however are exempt from VOSHA rules. Congress has for many years annually attached a “rider” to the OSHA appropriations bill prohibiting the expenditure of any funds to enforce any OSHA standard against a farming operation that employs ten or fewer employees. Family members are not considered farm employees.

If you employ 11 or more hand laborers doing field work, OSHA requires that you provide potable drinking water, handwashing facilities, and toilets to laborers in the field. Toilets – one for each 20 employees – and handwashing facilities are required when the employees are working for more than three hours per day. The facilities should be within a quarter mile walk. Hand labor includes using hand tools for cultivation, weeding, planting, and harvesting of fruits and vegetables, seedlings, and other field crops.²⁹

OSHA has also provided standards for roll-over protective structures,³⁰ slow moving vehicles,³¹ equipment guards,³² and the storage and handling of anhydrous ammonia,³³ logging operations,³⁴ and several other areas of safety concern on farms.



Family and Medical Leave

Agriculture is NOT exempted from either the federal or Vermont family or medical leave legislation. The federal Family and Medical Leave Act, however, applies only to employers with 50 or more employees in 20 or more workweeks in the current or preceding calendar year who are engaged in commerce or in any industry affecting commerce. The Vermont Parental and Family Leave Act, however, applies to much smaller employers.

Vermont employers with 10 or more employees for an average of at least 30 hours per week during a year must comply with the laws regarding parental leave, and those who employ 15 or more individuals for an average of at least 30 hours per week must comply with the Vermont Family Leave Act.³⁵

Parental Leave

Parental leave is warranted for the birth of the employee's child or the initial placement of a child 16 years of age or younger with the em-

ployee for the purpose of adoption.

Family Leave

Family leave is warranted for cases of: a serious illness of the employee or a serious illness of the employee's child, step-child, or ward who lives with the employee; foster child, parent, spouse, or parent of the employee's spouse. Serious illness means an accident, disease, or physical or mental condition that poses imminent danger of death, requires inpatient care in a hospital, or requires continuing in-home care under the direction of a physician.

Only employees that have been employed continuously by the same employer for a period of one year and for an average of at least 30 hours per week are eligible for parental or family leave, and they are entitled to the following.

During any 12 month period, an employee may take unpaid leave for a period not to exceed 12 weeks. The employer must continue employment

benefits for the duration of the leave at the level and under the conditions that coverage would have been provided if the employee had continued working as usual for the duration of the leave.³⁶ During the leave, the employee may take accrued sick leave or vacation leave or any other accrued paid leave as long as it does not exceed six weeks.

Upon returning to work, employees must be offered the same or a comparable job at the same level of compensation, benefits, seniority, or any other term or condition of employment that existed on the day that leave began.³⁷ However, there are two exceptions, as follows:

If, during the leave, the job would have been terminated or the employee laid off for reasons unrelated to the leave or the reason for the leave, or

If the employee performed unique services and hiring a permanent replacement during the leave was the only alternative available to the employer to prevent substantial and grievous economic injury to the employer's operation.



FARM LABOR REGULATION

Workplace Injury—Workers' Compensation

Workers' Compensation is a state-sponsored insurance program that compensates covered workers suffering death, injury, and/or disability in the course of their employment. The program is administered by the Vermont Department of Labor and Industry, and you can find information at <http://www.state.vt.us/labind/wcindex.htm>. Most employers are required to purchase Workers' Compensation coverage. In Vermont, it is of-

fered by private insurers.

Worker's Compensation is a covered employee's exclusive remedy for work-place injuries. If an employer has covered the employee, the employee can look only to the benefits and compensation offered through Workers' Compensation and may not sue in a private civil suit the employer or the employer's estate for injuries sustained on the job. This liability shield is the *quid pro quo* for employ-

ers. If employers provide insurance, the worker's remedy is limited to Workers' Compensation coverage and the employer's liability from a civil suit is limited.

The consequences for failing to cover an employee are serious. The law allows an employee who suffers a personal injury while working for an employer who is legally required to provide Workers' insurance but fails to do so, the right

Independent Contractors and Workers' Compensation

Under Vermont law, certain kinds of independent contractors are still considered to be employees for the purposes of Workers' Compensation and must be covered. The law seeks to make it more difficult for employers to skirt Workers' Compensation coverage by hiring independent contractors to carry out some of the basic or central aspects of their business. If the contractor is performing services that are closely related to the employers business they will likely be considered "statutory employees" and the law will impose a duty of coverage. For example, a Vermont

wood products manufacturer who hired an independent contractor to haul its lumber and load it on railroad cars was found to be a "statutory employer" of those providing the hauling because hauling and loading the lumber was an integral part of its business.⁴⁴ The statute provides a list of factors that must be present to exclude those providing services under contract and their employees from coverage. **These workers may be excluded from coverage when the individual:**

- performs work that is distinct and separate from that of the employer;

- controls the means and manner of the work performed;
- holds him or herself out as a business;
- holds him or herself out for work for the general public and does not perform work exclusively for one employer;
- is not treated as an employee for purposes of income or employment taxation with regard to the work performed; and/or
- services are performed by a written agreement or contract that explicitly states that the individual is not

considered to be an employee for purposes of workers compensation, has no employees, and is not a subcontractor. The contract must also include information regarding the individual's right to purchase Workers' Compensation and the individual's election not to do so.

Whenever work is provided by an independent contractor, the agreement should also specify that the contractor has covered their employees under workers compensation. Proof of that coverage should also be provided.



to bring a civil suit for full damages. The law also shifts the burden of proof to the employer in such a suit. The employer will have the burden of proving that the injury did not result from the employer's negligence. The employer's defenses are also limited, and the statute provides that for employees who prevail in the suit, the employer will be liable for costs and fees of suit, including attorney's fees.³⁸

Vermont exempts agricultural workers for an employer whose aggregate payroll is less than \$10,000 per year from carrying Workers' Compensation insurance. "Wages" include the market value of board, lodging, fuel, and other non-monetary benefits received from the employer.³⁹ "Workers" include interns and apprentices. Employers may exclude from coverage members of the employer's family who dwell in the employer's house.⁴⁰ Sole proprietors and partner owners may also be excluded from coverage although they may elect to be covered. Agricultural employers may also elect to cover employees otherwise excluded to take advantage of the liability shield from private suits by employees.

“Vermont exempts agricultural workers for an employer whose aggregate payroll is less than \$10,000 per year from carrying Workers' Compensation insurance.”

Workers' Compensation provides compensation for lost wages as well as vocational rehabilitation for injured workers. Workers with only a partial disability may be expected to seek work that suits their abilities when cleared to do so by a physician. Workers may also return to work with certain physician-prescribed restrictions.

Employers who regularly employ at least ten employees working more than 15 hours per week have an obligation to rehire workers who recover their ability to safely perform the duties of their old job. The employer need not make special accommodations if the employee is not able to perform the duties of their old job.⁴¹ The worker must fully recover within two years of the onset of the disability and must keep the employer informed of his continuing interest in the job.⁴² The worker is entitled to the first available position and upon reinstatement is to regain the seniority and any unused annual, personal, or sick leave.

Employers who discharge or refuse to employ someone because they have asserted a claim under Workers' Compensation open themselves to civil penalties for unlawful discrimination.⁴³



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Termination Issues

Vermont is an “employment-at-will” state. Unless an employee has an employment contract that provides otherwise, he or she may be discharged at any time — with or without cause. There is, however, a public policy exception to the employment at will doctrine. Vermont Courts will allow a discharge at will “unless there is a clear and compelling public policy against the reason advanced for the discharge.”⁴⁵

Whether a discharge offends public policy is a matter of “community common sense and common conscience, extended and applied throughout the state to matters of public morals, public health, public safety, public welfare” and whether an employer’s action is “cruel or shocking to the average [person’s] conception of justice.”⁴⁶

The Vermont Supreme Court has held that an at-will firing solely on the basis of the age of the employee is contrary to public policy.⁴⁷ The court has also suggested that firing an employee for refusing to violate a clear and compelling professional code of conduct adopted to protect the public might also be contrary to public policy.⁴⁸

Certain kinds of retaliatory firings that punish a worker for exercising rights afforded to all employees are also unlawful. A retaliatory firing for filing a claim of unlawful discrimination under the

Vermont Fair Employment Practices Act is specifically prohibited by statute.⁴⁹ A retaliatory firing of an employee for filing a Worker’s Compensation claim is also specifically prohibited by statute.⁵⁰

Other Exceptions to the At-Will Doctrine

An employer’s written policies and practices may also modify the employment-at-will doctrine.⁵¹ When an employee manual implies that an employee will only be fired for cause, Vermont Courts have required cause. If the manual includes a procedure to be followed prior to a termination, Vermont Courts are likely to hold the employer to that procedure. Whenever an employee manual implies there is job security and seeks to garner employee loyalty in exchange for job security, a Vermont Court will enforce the language of the manual. Vermont Courts have done so even where the manual was prefaced with bold language stating that the manual did not constitute an employment contract and that employees were employed at will and could be terminated at any time and for any reason.⁵² Boilerplate language denying that the manual is an employment contract will not effectively negate policies and procedures that clearly indicate otherwise.

“The Vermont Supreme Court has held that an at-will firing solely on the basis of the age of the employee is contrary to public policy.



Worker Housing

The State of Vermont provides a special, expedited eviction process for agricultural workers who fail to vacate housing provided by an employer at the termination of their employment.⁵³ The employer must earn at least one-half of their gross income from farming and the housing must be provided to the employee without any expectation of payment other than utilities. The housing must at least be “controlled” by the employer and it may be located on or off the farm.

The farm employee housing statute gives employers the right to terminate the tenancy at the termination of employment but requires the employer to follow certain procedures as follows:

- You must provide written notice, served by a law officer, to the former employee. The notice must be served together with a summons and complaint seeking a writ of possession to remove the

“You must provide written notice, served by a law officer, to the former employee.

farm employee. The language you must use to give notice is provided in the statute – 9 V.S.A. §4469(c).

- Within 10 days of the service of notice and summons, the court will hold a hearing to allow the employer to establish that the failure of the employee to leave is causing actual hardship to the employer because of unavailability of farm housing for a replacement employee.
- If the employer establishes actual hardship, the court will issue a writ of possession.

If the employee has counterclaims against the employer, such as a claim of wrongful termination, the right to pursue that claim will be preserved. A counterclaim will not delay removal of the former employer. The employee will still be allowed to seek whatever relief might be available under the law.



FARM LABOR REGULATION

Case Study: Labor Management at North Williston Cattle Company

By Deb Heleba

North Williston Cattle Company is owned and operated by the Whitcomb family. Located in Chittenden County, the 300-cow dairy farm employs family members as well as full- and part-time employees. Mary and her husband, Onan, supervise the dairy end of the business, and Onan's brother, Lorenzo, oversees the crops and field work.

In addition to family labor, two full-time employees work year-round in the dairy and there are two to three part-time milkers. Lorenzo also hires a number of seasonal employees to help with the field work.

The farm sees very little turn-over in labor. In 15 years, they've had to fire only one employee. Mary attributes their employee retention to their careful recruitment and selection process, communication practices, and their positive attitudes about farming and farm labor – these all help make the farm a rewarding and fun place to work. When someone does leave, it tends to be a life-change decision, that is, they are graduating from college, making

a career change, and/or moving away from the area rather than making a decision based on job satisfaction.

The employee mix is diverse in terms of age, gender, background, and full-versus part-time status. Employees range from 18 to 72 years old; some have never farmed before, while others have farmed their entire lives. For example, one of their employees is a 61 year-old man who works in the dairy full-time. He operated his own dairy farm for 40 plus years but when he was ready to slow down, he still wanted to work with animals. Another employee is a UVM pre-vet student who is interested in gaining large animal experience. She works as a part-time milker. Another part-time employee also works full-time for IBM. He had fond childhood memories of his family's farm and because he has a flexible work schedule at IBM with three days on and two days off, he is able to work at North Williston Cattle Company for two weekends a month in exchange for housing. This allows the other employees, including Mary and Onan, to take off for up to two weekends a month.

Employee Recruitment

When looking for a full-time employee, Mary starts the process by writing an advertisement that begins with the letter "A." Most classified sections run their ads in alphabetic order and Mary says she wants to make sure that their ad is the first that people see. The ad might start out as "Animal lover..." or "A farm job..." or even, "Agriculture..." Typically, they will choose to place their ad in a local paper such as the Burlington Free Press rather than an agricultural publication. By doing this, they draw a wide variety of candidates. Likewise, they place the ad in the regular classified section as opposed to the farm section unless there are no other listings there. Mary says she wants the farm to be the only one listing a help-wanted ad and will sometimes wait to post their ad so they can achieve this.

The advertisement includes the farm name and location so that candidates will know who they're calling.

To keep abreast of the labor market, Mary takes note of any area plant closings. For example, if a plant in St. Johnsbury closes and lays off 150 people, Mary will keep a note on file.

When it's time to hire, Mary posts a help-wanted advertisement in the St. Johnsbury newspaper. She keeps a list of all the newspapers in which she's placed an ad and includes the number and types of candidates it drew.

When the ad runs, the Whitcombs let the answering machine take all calls. In the evening when they aren't rushed, they review them. Everyone who inquires about the job gets a return call. That can mean two hundred or more return phone calls. Mary writes up a job description and directions to the farm, and keeps this information by the phone in case someone else returns these calls. The person returning the call reads the job description to potential applicants and discusses hours and housing options. However, they do not discuss salary because this is negotiated, depending on background. If the caller still wants to pursue the position, Mary schedules an interview.

Mary estimates that of 150 inquiries about one job opening, they know that there are about 120 people they won't

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FARM LABOR REGULATION

Case Study: Labor Management at North Williston Cattle Company (continued from page 110)

want to pursue. However, they don't discourage anyone from an initial visit to the farm. Even so, Mary says that about half of the candidates don't show up for their visit and interview.

For the first face-to-face meeting, Mary gives the candidate a half-hour tour of the farm. At this time, applicants receive a job application, which includes solicitation of two references: one from an employer, one from a landlord. It includes the question, "why do you want to work on this farm?" The application also includes a skills checklist where the applicant can check his or her level of ability and interest in learning for each farm skill—carpentry, artificial insemination, mechanics, electrical work, health care—as follows: a) know a lot; b) don't know and have no interest in learning; and c) don't know but have an interest in learning. If the person is hired, Mary said that the answers to the checklist can help them tweak the job responsibilities to fit the employee's strengths and interests.

Following the initial visit and completion of the application form, the

candidate is invited back to the farm to spend a morning or evening milking with the family and other employees. Then each of the final candidates has an interview with Mary, Onan, and Lorenzo before being hired.

Once the Whitcombs choose to hire an applicant, they ask them to complete a tenant agreement for the on-site housing but do not ask for an employee contract. The tenant agreement includes a stipulation that if employment is terminated, the employee and his or her family will be expected to vacate the premises within one week. Every adult who will be living in the house signs the tenant agreement.

Mary keeps a file of all applicants who seemed particularly appropriate. She calls these applicants to let them know that they've filled the position but will keep their application on file. Mary also keeps a separate file of all applicants who were particularly inappropriate so that she will have a record of folks who have raised "red flags" in the past.

This is a costly process. Mary estimates that it costs \$200 for the advertisement alone, plus countless

hours returning phone calls, scheduling tours, interviewing candidates, and following-up with rejected applicants. However, she said it is definitely worth the effort to spend the time and money to hire the right employee, versus dealing with the hassles of managing and/or terminating an employee hired on impulse. "Thankfully," she says, "we don't have to go through this process very often."

Employee Benefits

For full-time employees, North Williston Cattle Company provides salary, on-site housing, health insurance, a half of a beef per year, garden space, and utilities—electricity, garbage removal, and water. Employees also receive one week of paid vacation and four days of emergency leave, but no paid sick days. If they work on the farm for at least 3 years, the farm will pay health insurance for their spouse or domestic partner and after 5 years, the farm will provide a co-payment for a family insurance plan.

For part-time employees, the starting wage is \$8.50 per hour. After six

months, part-timers get paid \$9/hour plus one tank of gas per week.

The farm carries worker's compensation on all employees. In addition to these tangible benefits, the Whitcombs believe that making the farm an enjoyable place to work is important. To that end, they try to build camaraderie among the employees. Mary says, "We want to build community on this farm. We're committed to know these people like our own family—I know where their children go to school, what sports they play, where their parents work."

Each summer, the Whitcombs host a picnic for their employees and families. In the past, they also hosted a holiday dinner at a local restaurant every year.

The "Red Book"

Several years ago, Mary created the "red book." This is a three-ring binder of protocols for all the day-to-day activities on the farm. Mary said, "I had a terrible fear that if something happened to my husband and brother-in-law, I wouldn't

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FARM LABOR REGULATION

Case Study: Labor Management at North Williston Cattle Company (continued from page 111)

know what to do if 'X' broke, and the farm would go under." The binder seeks to answer a wide range of questions about the farm – how to treat mastitis, where the water lines to the well run, who services what – plumbers, welder, electrician, and so on. It lists all supplies and equipment used on the farm, where they are purchased, and how to fix or replace them. It includes an emergency section that covers the "what ifs"—what to do if there's a flood in the parlor, what if the milk truck is late, what if the farm loses power – how to hook up the generator and the phone number for Green Mountain Power. The book even covers what to do if the media comes to the farm. It says, "Everyone has a happy face, clean boots, and clean jackets." Everyone knows where to stand – by the farm sign – if pictures or footage are taken, and knows to stay with the reporter to ensure that only the best views of the farm are shot.

When employees start working on the farm, they are introduced to the Red Book. After they are trained, if they have questions about a procedure, they are encouraged to consult the Red Book first – if their question is not addressed there, Mary will help them and their question is added to the binder for the next time someone has that question.

In addition to the Red Book, Mary posts listings of tasks that need to be attended to every day, those that need attention each week, and tasks that can be done whenever there's some extra time. She said, "Our employees are motivated and want to keep busy." The lists serve as reminders of what needs to be done and what employees can do on their own, without being asked.

Termination

Mary said they have only had to fire one person in 25 years. In hindsight, she said she should not have veered

from her normal recruitment and hiring procedures, but the employee was very charismatic and convinced the Whitcombs to hire her without first checking references.

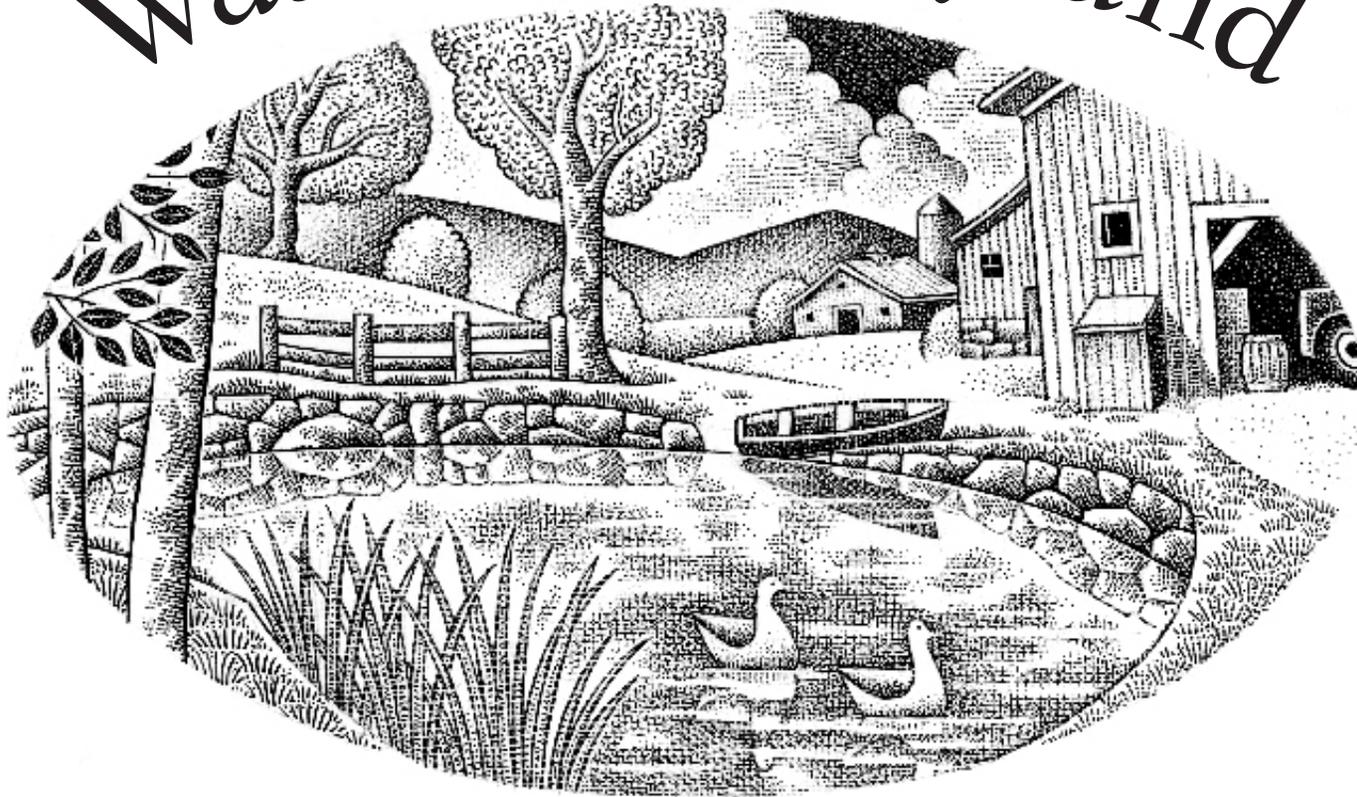
The Whitcombs' approach to troublesome employee behavior is to first give the employee a verbal warning. This is followed by two written warnings; each time, the employee meets with Mary, Onan, and Lorenzo to review the written warning, which includes a description of the problem, the proposed solution, and avenues for improvement. They ask the employee to sign the written warning to acknowledge that he or she understands the grievance. In the case of the employee whom they fired, there was no improvement after the verbal and written warnings, so the Whitcombs gave a two-week termination notice. Mary said that having written documentation was extremely helpful because this employee tried

to collect unemployment benefits, citing wrongful termination. Without this documentation, the Whitcombs would have had to pay unemployment payments, but with it, they could show cause for the termination.

Attitude about Employees

Mary said, "Our employees are what make the farm work. They are our biggest resource." She says that at many farmer meetings, she hears farmers disparaging their labor, "we will never do that," she said. "When there is nothing good said about agriculture, it perpetuates. I encourage everyone to work on a farm. It's a wonderful work experience." Mary tells other farmers to look at the local market for workers and be flexible and open to the options.

Water Quality and



Environmental Regulation

By Sandy Levine and Laura Bucher



WATER QUALITY AND ENVIRONMENTAL REGULATION

Agricultural Land Use Practices and Water Quality¹

Under Vermont law, all farms must comply with “agricultural land use practices.” Agricultural land use practices fall into two categories: 1) accepted agricultural practices (AAPs) and 2) best management practices (BMPs).

All farms are required to follow AAPs to manage waste and other activities that could cause water pollution. The AAPs are standards for farmers to follow and address such activities as animal waste management and disposal, soil amendment applications, plant fertilization, and pest and weed control. For example, the AAPs prohibit spreading manure in the winter, require stream buffers in areas where runoff enters streams, and require that manure not be stacked in fields in a manner

that would create a concentrated overland flow of manure runoff. Farmers who comply with AAPs are presumed to be in compliance with Vermont water quality standards.²

Under recent legislation, the Vermont Agency of Agriculture, Food and Markets (VAAFMM) was directed to revise the AAPs. The final proposed rule can be found at: <http://www.vermontagriculture.com/AgriculturalWaterQuality/AAP/AAP10.htm>. One change under the new AAPs will be a process by which VAAFMM must investigate complaints from property owners regarding groundwater or drinking water contamination from a farm.³

Although AAPs enforcement actions by the VAAFMM are rare, they are allowed by statute. Farmers who con-

duct practices that are inconsistent with AAPs may receive a written warning from VAAFMM. If a response or corrective action is not taken, a cease and desist order is issued that is followed by enforcement action and administrative penalties if it is violated.⁴

In certain circumstances and on a case-by-case basis, BMPs may also be required. The statute does not define BMPs, but they typically provide a higher level of protection for water quality and can require the installation of structures or investment in equipment. Examples of some BMP requirements are vegetative buffers to help filter runoff, stringent setback distances for manure application, development of alternative uses of manure, irrigation system management, and thorough record-keeping.

Waste Storage Facilities⁵

State law has requirements for waste storage facilities. New waste storage facilities must meet standards set by the United States Department of Agriculture (USDA) and, beginning July 2006, expanded or modified waste-storage facilities must

also meet these standards.⁶ This is true whether or not the storage facility receives federal or state cost share. The USDA standards are developed by the Natural Resources Conservation Service and include such requirements as a safe location, ad-

equated storage volume, adequate liners, and erosion protection. If there is a threat to human health or the environment, VAAFMM may require the modification of existing waste storage facilities to meet the standards as well.⁷



Water Quality Permits

Depending on the size of a farm and whether there is a discharge that would pollute surface

water, water quality permits may be required. A farm may need a state permit, a federal permit,

or both, depending on whether there is a direct discharge into surface waters.

A farm requires a state water quality permit in the following circumstances:

- 1) to construct a new barn or expand an existing barn to house a certain number of animals – enough to qualify it as a “Large Farm Operation (LFO)”,
- 2) to operate an LFO,
- 3) to operate a “Medium Farm,” or
- 4) to operate a “Small Farm” if the VAAFMM decides the small farm requires a permit.

An LFO does not need a construction permit to replace and use an existing barn in the same way. The definitions of large, medium, and small farms are in the relevant Vermont statute.⁹ A large farm is any farm that has over 700 mature dairy animals or a comparable number of other animals. Medium farms are those with 200-699 mature dairy animals or a comparable number of other animals, and small

farms have fewer animals than medium farms. Both medium and small farms have barnyards that do not grow vegetation during the normal growing season.

There are currently about 20 farms in Vermont with a large farm operation (LFO) permit. These permits were originally designed as a means for large “Concentrated Animal Feeding Operations” (CAFOs) to avoid needing a federal National Pollutant Discharge Elimination System (NPDES) permit, which is covered in more detail later in this section, and to provide a means to review other large-farm impacts such as odor, noise, traffic, and flies.

The public participates to some extent in farm permitting decisions. For instance, VAAFMM must hold an informational meeting when an LFO applies for a construction permit. For Small and Medium Farm permits, VAAFMM must give public notice and hold a hearing. Applicants may appeal VAAFMM’s permitting decision for a farm of any size; other interested persons may appeal Small and Medium Farm permitting decisions. Enforcement remedies for Small, Medium, and Large Farm violations are similar and

include monetary penalties, permit revocation, and extra fines for false statements.

Large Farm Operations¹⁰

A LFO must have a permit to construct or to operate. When a farm applies for an LFO permit, it must provide a written description of the proposed construction, if any; proposed nutrient management plan (NMP); and proposed manure management plan. The VAAFMM is also in the process of developing new rules for LFOs that will include standards regarding setbacks or siting criteria and groundwater contamination, including a process for neighbors’ complaints. Existing standards include waste management and storage, odor, noise, traffic, insects, flies, and other pests.¹¹ For example, barnyard or feedlot runoff must be diverted to a storage or treatment area. The secretary may condition or deny a permit on the basis of odor, noise, traffic, insects, flies, or other pests¹² if these impacts are not managed to the same level as on a well-managed farm of a similar size and with the same types of animals.¹³



WATER QUALITY AND ENVIRONMENTAL REGULATION

Medium Farms¹⁴

A medium farm must have a permit to operate and can usually seek coverage under a general permit, which is a standard permit to cover all medium farms. Currently, VAAFM is developing the specific requirements for the Medium Farm general permit, which will include standards for waste management and storage; a nutrient management plan

(NMP); carcass disposal; surface and ground water contamination, including a process for neighbors' complaints; and reporting and monitoring requirements. The final proposed Medium Farm general permit rules can be found at: <http://www.vermontagriculture.com/AgriculturalWaterQuality/MFO/MFO.htm>. Under certain circumstances, after a review of various factors such as a farm's history of compliance, VAAFM may require a Medium Farm

to obtain an individual permit, which may be more stringent than the general permit.

Small Farms¹⁵

A small farm may, but is not required to, seek coverage under the Medium Farm general permit. As with medium farms, in certain circumstances, VAAFM may require a small farm to obtain an individual permit.

Large and Medium Farm Operations as Defined under State Law

Vermont's agricultural water quality legislation defines a "large" farm as follows:

An operation with more than 700 mature dairy animals, 1,000 cattle or cow/calf pairs, 1,000 veal calves, 2,500 swine weighing over 55 pounds, 10,000 swine weighing less than 55 pounds, 500 horses, 10,000 sheep or lambs, 55,000 turkeys, 30,000 laying

hens or broilers with a liquid manure handling system, 82,000 laying hens without a liquid manure handling system, 125,000 chickens other than laying hens without a liquid manure handling system, 5,000 ducks with a liquid manure handling system, or 30,000 ducks without a liquid manure handling system.

A "medium" farm operation is

defined as follows:

A facility or lot that houses 200 to 699 mature dairy animals, 300 to 999 cattle or cow/calf pairs, 300 to 999 veal calves, 750 to 2,499 swine weighing over 55 pounds, 3,000 to 9,999 swine weighing less than 55 pounds, 150 to 499 horses, 3,000 to 9,999 sheep or lambs, 16,500 to 54,999 turkeys, 9,000 to 29,999 laying hens or broilers

with a liquid manure handling system, 25,000 to 81,999 laying hens without a liquid manure handling system, 37,500 to 124,999 chickens other than laying hens without a liquid manure handling system, 1,500 to 4,999 ducks with a liquid manure handling system or 10,000 to 29,999 ducks without a liquid manure handling system.



Federal Clean Water Act Permits¹⁶

The Clean Water Act prohibits discharging pollutants into waters without a permit.¹⁷ Under new state legislation, when a farm applies for a state water quality permit, the VAAF¹⁸ should tell the farm whether the farm also needs a federal Clean Water Act (CWA) permit. It is important to realize that even if a farm has a state water quality permit, it may still require a federal CWA permit if it has a direct discharge of pollutants into surface waters such as streams, brooks, rivers, or lakes. In Vermont, the Agency of Natural Resources (ANR) issues federal CWA NPDES permits.

A farm requires an NPDES permit if it directly discharges polluting materials into certain waterways in certain ways. For example, if a farm uses a manure spraying system that sprays manure into a nearby stream, the farm needs a permit. Also, if a farm stacks manure or other wastes next to a ditch and the wastes run into a stream through the ditch, the farm needs a NPDES permit.

If a farm qualifies as a CAFO under the CWA, then a special set of regulations apply to it. In addition to other discharges, CAFO runoff from the land application of manure or other wastes requires an NPDES permit. However, if the wastes were not over-applied to fields, runoff that is caused primarily by precipitation is exempted from the permitting requirement.

Federal NPDES permit conditions include limits on the quantity of pollutants a CAFO can discharge.

Concentrated Animal Feeding Operation (CAFO) Defined

Under the Clean Water Act, a “CAFO” is an animal feeding operation (AFO) that is a “large CAFO,” a “medium CAFO,” or is generally designated as a CAFO by the appropriate authority.¹⁸

An “AFO” is a lot or facility where animals “have been, are, or will be stabled or confined and fed or maintained for a total of 45 days or more in any 12-month period” and where “[c]rops, vegetation, forage growth, or post-harvest residues are not sustained in the normal growing season over any portion of the lot or facility.”

A “large CAFO” has (i) 700 mature dairy cows, whether milked or dry; 1,000 veal calves; or 1,000 cattle other than mature dairy cows or veal calves. Cattle includes but is not limited to heifers, steers, bulls, and cow/calf pairs; 2,500 swine each weighing 55 pounds or more; 10,000 swine each weighing less than 55 pounds;

500 horses; 10,000 sheep or lambs; 55,000 turkeys; 30,000 laying hens or broilers, if the AFO uses a liquid manure handling system; 125,000 chickens other than laying hens, if the AFO uses other than a liquid manure handling system; 82,000 laying hens, if the AFO uses other than a liquid manure handling system; 30,000 ducks if the AFO uses other than a liquid manure handling system; or 5,000 ducks if the AFO uses a liquid manure handling system.

A “medium CAFO” has 200 to 699 mature dairy cows, whether milked or dry; 300 to 999 veal calves; or 300 to 999 cattle other than mature dairy cows or veal calves. Cattle includes but is not limited to heifers, steers, bulls, and cow/calf pairs; 750 to 2,499 swine each weighing 55 pounds or more; 3,000 to 9,999 swine each weighing less than 55 pounds; 150 to 499

horses; 3,000 to 9,999 sheep or lambs; 16,500 to 54,999 turkeys; 9,000 to 29,999 laying hens or broilers, if the AFO uses a liquid manure handling system; 37,500 to 124,999 chickens, other than laying hens, if the AFO uses other than a liquid manure handling system; 25,000 to 81,999 laying hens, if the AFO uses other than a liquid manure handling system; 10,000 to 29,999 ducks if the AFO uses other than a liquid manure handling system; or 1,500 to 4,999 ducks if the AFO uses a liquid manure handling system) and discharges to waterways through a ditch or directly into a watercourse.

A “small CAFO” has fewer animals than a medium CAFO and has been designated as a “CAFO” by the appropriate authority because it contributes significant amounts of pollutants to waterways.¹⁹



WATER QUALITY AND ENVIRONMENTAL REGULATION

Nutrient Management Plans (NMPs) are also included in the permit, as well as recordkeeping and reporting requirements. An NMP includes terms that ensure adequate storage of wastes; ensure proper management of mortalities; ensure that clean water is diverted from the production area—e.g., the animal confinement area; prevent direct contact between confined animals and applicable waters; ensure that chemicals are properly treated; identify site-specific conservation practices to control runoff; identify protocols for testing wastes; establish protocols for land application that ensure utilization of nutrients; and identify specific records that need to be kept.

For land application for large CAFOs, a permit will require application rates that will minimize pollution, annual manure and soil analysis, and 100-foot setbacks or 35-foot vegetated buffers from surface waters. Land application areas are covered by the permit, and the farm must not discharge polluting materials through ditches or pipes into waters. Records must be kept to show how manure is handled, and manure storage must be sufficient to prevent a discharge during a 25-year, 24-hour rainfall event.²⁰ There must be a waste storage management plan and routine inspections of the storage and handling facilities. If waters near the farm have excessive pollution and runoff from the farm is likely to add to that pollution level, additional measures may be required to effectively prevent the addition of any new pollution.²² Additionally, large CAFO permits have requirements for transferring wastes. When the

Agency of Natural Resources (ANR) issues a permit to a CAFO, the process is open to public notice and comment and the final permit may be challenged in court by an “interested” or “aggrieved” person.²²

If a farm adds pollution to waterways through a ditch or culvert and the farm does not have a permit, it violates the CWA. Any farm that violates the CWA must either obtain an NPDES permit or stop discharging. Otherwise, it will be subject to enforcement by the Vermont Agency of Natural Resources or by a citizen’s suit. Before any CWA enforcement action can be brought, the farm must be given 60 days notice of the specific complaint in order to allow the farmer an opportunity to fix the problem. Remedies include monetary penalties, abatement orders, and attorneys’ fees. Once a farm has an NPDES permit and is in compliance with the permit, the farm is basically protected from CWA enforcement actions.

Total Maximum Daily Load Program (TMDL)

The Federal Clean Water Act requires states to identify waters that do not meet water quality standards and establish a total maximum daily load (TMDL), or amount, of a single pollutant a waterbody can receive from all sources and still meet water quality standards. The pollution load is then allocated to all sources of pollution within the area that discharges into the waterbody. Discharge permits must

be based on and include this allocation. Vermont has a TMDL for phosphorus pollution in Lake Champlain. Runoff from agricultural land is one of the largest contributors of phosphorus pollution to Lake Champlain.²³ Under the TMDL, farms that have discharge permits for areas of Lake Champlain subject to the TMDL are required to remain within the TMDL discharge levels and have a responsibility to reduce manure and fertilizer runoff and to control erosion.²⁴ Under recent legislation passed in Vermont, additional funding is available for farmers to develop and implement NMPs and put in place other measures, such as buffer protection, fencing, and farm structures, to better manage runoff, control erosion, and reduce the amount of phosphorus that enters Lake Champlain.

Requirements Dependent upon Adequate Funding

Some state water quality requirements are necessary only if there is adequate funding to implement them. However, there is no similar limitation for federal requirements. For example, a farm could have a state Medium Farm permit and a federal NPDES permit and both permits could include a nutrient management plan. The farm can apply for financial assistance to implement the NMP in the state permit; if funding is denied, the farm is released from the state NMP. However, the farm would remain obligated to implement the federal NMP.



WATER QUALITY AND ENVIRONMENTAL REGULATION

Example Checklist for a Farm with 30 Mature Dairy Cows

- The Farm is automatically required to follow Accepted Agricultural Practices (AAPs).
- The Agency of Agriculture may require a Farm to also follow Best Management Practices (BMPs) if they are needed to protect water quality.
- If the cows are confined for at least 45 days or more in a year, and if vegetation does not grow in the confinement area during the normal growing season, the Farm is a “Medium Farm Operation” and must obtain an operating permit from the state of Vermont.
- If the farm fits the above criteria and also directly discharges pollution to waterways, it must obtain a federal Clean Water Act permit.
- Even if the farm does not qualify as a “Concentrated Animal Feeding Operation (CAFO)” because it either does not confine its cows for at least 45 days or more in a year or does sustain vegetation in the confinement area during the normal growing season, it must still obtain a federal Clean Water Act permit if it directly discharges to waterways from a pipe, sprayer system, ditch, or the like.

Conservation Assistance Programs

Several state and federal programs provide both financial and technical assistance to farmers to assist them in their efforts to reduce water pollution from farm runoff. The state programs operate jointly with the federal programs. Information about the various programs is available from the Natural Resources Conservation Service (NRCS) at www.nrcs.usda.gov/programs/.

Assistance includes designing and sharing the cost of needed improvements, including manure pits, fencing, and even manure digesters. Funding is also available as payment for taking land out of production in sensitive areas to protect water quality or to plant filter strips or trees in areas that are near waterways to protect water quality.

A brief summary of programs and how they have been used in Vermont follows:

Conservation Innovation Grants²⁵ are avail-

able for the purpose of encouraging development of groundbreaking conservation practices pertaining to water, soil, grazing land, wildlife habitat, and improvement of forest health. The grant will cover 50 percent of the costs of the project as well as necessary technical assistance.

Example: A cattle farm in Colchester, VT, received \$198,572 in 2004, as assistance in a project designed to recover heat from decomposing manure to heat water as well as the farm facility. The farmers also devised a system of straw-based composting to aid in farm erosion control in vulnerable areas abutting stream banks.

Environmental Quality Incentives program (EQIP)²⁶, the most popular program in Vermont, provides funding for projects to address water quality degradation from erosion and manure runoff. Ex-

amples include payment for fencing to limit trampling of stream banks and construction of manure pits used to store waste. EQIP through state and federal funding provides existing farmers with up to \$250,000 based on a 35 to 75 percent cost-share. In addition, new farmers who have been farming for fewer than 10 years or make less than \$100,000 can receive up to 90 percent cost-share. Applicants are ranked to determine whether they are a “significant contributor” to water quality degradation, and the higher the rank the greater the probability of funding.

Example: A dairy Farm in Alburg, VT, has used EQIP assistance to 1) divert pasture surface water away from waste storage facilities, 2) provide clean water to animals while keeping them out of streams by installing fencing, and 3) institute other conservation methods as detailed in a comprehensive management plan.



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The Wetland Reserve Program²⁷ is targeted to protect and restore wetlands and buffers. Payments are made for permanent or 30-year easements on agricultural properties. These payments reimburse 75 percent of restoration costs as well as 75 percent of rental payment costs. The land must be wetlands or adjacent to protected wetlands and contribute significantly to wetlands functions. To qualify, the land must have been used for farming.

Example: In 2004, Wetland Reserve Funds were used in Vermont to fund restoration activities on the Hubbardton River in West Haven, Vermont. Funds were allocated for a permanent easement in Pittsford, Vermont, to convert 425 acres of land that was retired from agricultural use and that bordered the Otter Creek into wetlands.

The Conservation Reserve Program (CRP)²⁸ provides funding over a ten or fifteen-year period while land vulnerable to erosion or runoff is voluntarily taken out of production. The program provides an annual soil rental payment and annual incentive payments of \$10 per acre as well as a cost-share to reestablish native vegetative buffers or fence the land near a stream to prevent livestock from grazing the buffer plants and contaminating the water. CRP provides assistance in areas the Conservation Reserve Enhancement Program (CREP) program does not, such as land surrounding well-head areas and areas where other conservation practices are in place.

Conservation Reserve Enhancement Program (CREP) has very similar goals to CRP, but provides

higher payments because the program receives both federal and Vermont State funds. The program funds up to 90 percent of project implementation costs, doubles the annual soil rental payments of CRP, and the state of Vermont provides additional incentive payments depending upon the type of land enrolled in the program. CREP targets farm lands adjoining streams and land that is susceptible to erosion. Land is typically planted with a vegetative buffer strip or a forest riparian buffer to trap runoff. Buffers can be established on crop land or marginal pasture land. Participants can choose a fifteen- or thirty-year term, during which time the land along the river is voluntarily taken out of production and planted as a buffer. Additional conservation practices include grassed waterways, filterstrips, and forested buffers.

Example: An organic farm in St. Albans, VT, along a tributary to Lake Champlain, enrolled in CRP to retire land bordering the tributary and plant a buffer strip to inhibit field runoff containing nutrients from entering Lake Champlain.

The Conservation Security Program (CSP)³⁰ is currently available in just two watersheds in Vermont. CSP includes the West River and Otter Creek Watersheds and the Hudson-Hoosic Sub-Watershed Basin. The program provides technical and financial assistance to encourage conservation and improvements to the soil, water, air, or plant and animal life. In addition, farmers can receive added compensation for implementing renewable energy practices and technologies. Three tiers with increasingly stringent conservation requirements and escalating payment

systems are used to determine compensation. Tier I payments are available for achieving a minimum level of soil and water quality protection on a part of the farm. This might include soil testing on some fields, for example, to ensure proper nutrient management. A Tier II payment would compensate the adoption of these soil and water quality practices on the entire farm. For example, adopting a whole farm rotational grazing plan or a whole farm nutrient management plan might qualify for a Tier II payment. Tier III payments are made for comprehensive and innovative practices – the installation of wind turbines or the use of methane to meet the farm's energy needs. Farmers must have full control over the land during the period of the program. Eligibility requirements for the tier rating system are available on the CSP web site at <http://www.nrcs.usda.gov/programs/csp/>.

The Agricultural Management Assistance Program (AMA)³¹ gives assistance to reduce the impact of farm operations on stream and water quality. In 2004, the AMA program distributed a total of \$206,733 to farmers in Vermont. AMA provides up to \$50,000 per farmer for planting trees, creating windbreaks, improving dams, improving water quality, developing irrigation systems, implementing soil erosion control measures, practicing integrated pest management, or making a transition to organic farming.

Example: In 2004, the AMA program allocated 13 contracts to assist with stream bank stabilization as well as to assist farmers who wished to transition from traditional farming practices to organic methods.



WATER QUALITY AND ENVIRONMENTAL REGULATION

State Programs

The following programs are a part of the State-Managed Clean and Clear Action Plan Program.

Integrated Crop Management Program (ICM)³² is a state-funded program that assists farmers as they develop and implement nutrient management plans. Farmers receive \$6/acre to develop a plan. The maximum allowed for plan development and implementation per farm is \$13,000. After the plan is developed, farms receive an additional \$2000 per year for three subsequent years.

Best Management Practices Grant (BMP)³³ is a state program used to fund individual standalone projects such as building new manure lagoons to prevent barnyard run-off. Practices must be designed to NRCS standards. The program provides a cost-share of up to 50

percent with a cap of \$50,000/year. Farmers who are unable or unwilling to comply with EQIP's requirements often apply for this grant, although farmers are encouraged to apply for EQIP funding first because the BMP program can supplement EQIP funding.

Alternative Manure Management Technology Grants³⁴ is a state and federally funded program designed to encourage development of technologies associated with nutrient management. Technology goals include reducing odors, separating liquids from solids, and extracting nutrients from manure. Projects are encouraged develop ways to transform manure components into marketable and/or usable products, limiting the need for storage and manure spreading. Funding generally allows up to \$150,000 from state funds with up to a 50 percent cost share

Example: In Addison County, a large farm has utilized Central Vermont Public Service's cow power program and is using an anaerobic digester to produce electricity and decrease manure odor. The solid byproducts from the program are non-toxic and can be dried and used as a bedding material for livestock. The remaining liquid fraction has a reduced odor and can be placed on the field as a fertilizer. The system should reduce greenhouse gas emissions by converting methane to carbon dioxide.³⁵

To apply for specific federal programs, contact your local USDA Service Center or point your web browser to either: <http://forms.sc.egov.usda.gov/eforms> or <http://www.grants.gov/>. For state Clean and Clear programs, visit <http://www.anr.state.vt.us/cleanandclear>.



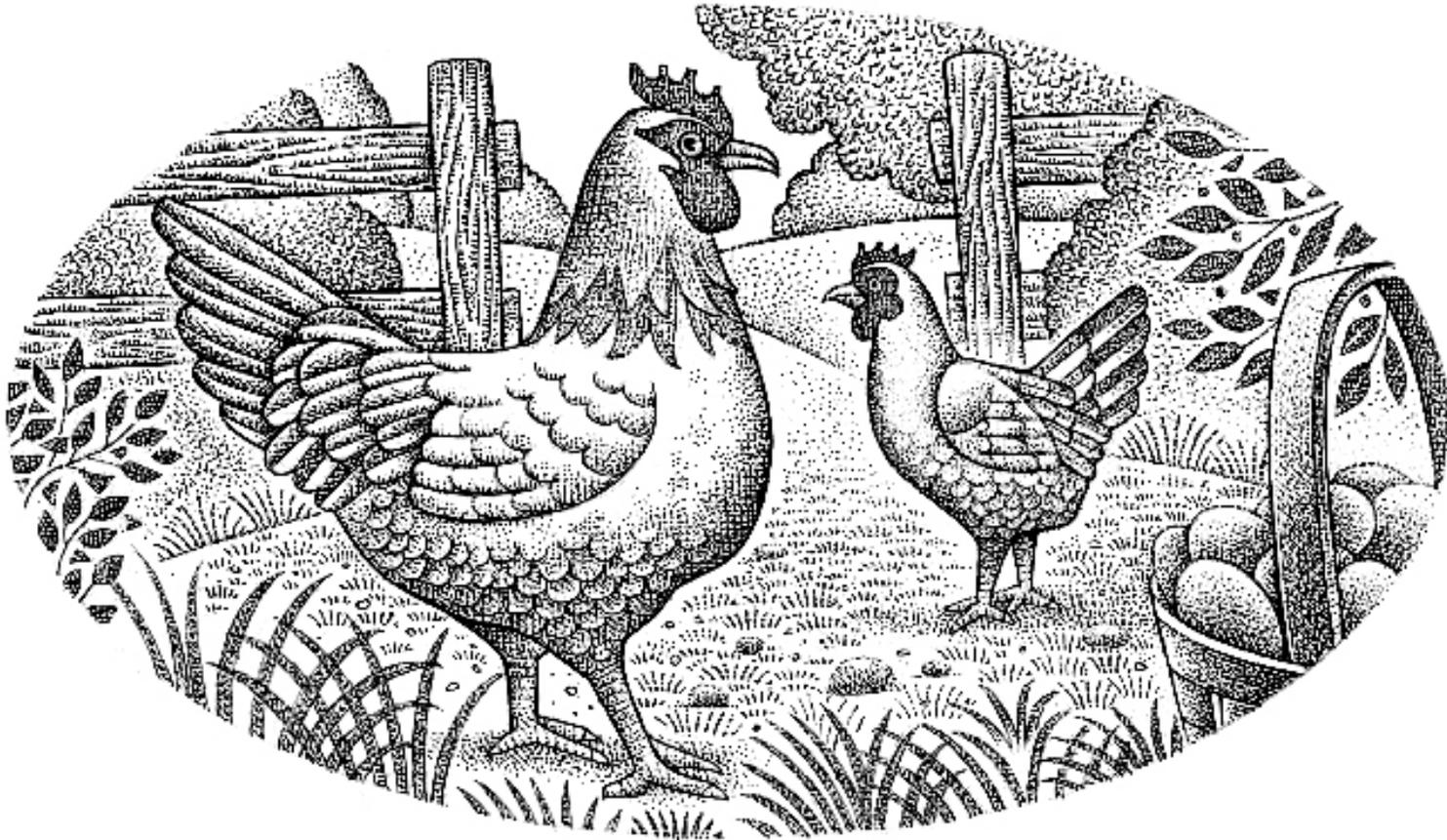
WATER QUALITY AND ENVIRONMENTAL REGULATION

Summary of USDA and State Conservation Programs

Program	Description	Techniques	Term	Cost Share	Other Benefit	Aid
CIG	Innovation	Innovations to improve: water, soil, grazing land, wildlife habitat, and forest health.	1-3 year projects	50%	Technical Assistance	Federal Max \$75,000
EQIP	Erosion Control/ Nutrient Management	Install vegetative buffers, stream bank fencing, manure pits.	1- 10 years	35-50% up to 90%*	Incentive payments for other practices	Federal, State Aid Max \$250,000/yr
WRP	Wetland Restoration	Install vegetative buffers, restore wetlands.	30 year Permanent	75%	75% rental costs	Federal Aid
CRP	Protect Water Quality (well-head areas, streams)	Restore buffers, stream bank fencing.	10 years 15 years	up to 90%	Up front: \$10/acre /yr Soil rental+ rate/acre /yr	Federal Aid
CREP	Protect Water Quality (streams)	Restore buffers, stream bank fencing	15 years 30 years	up to 90%	Upfront up to \$137/acre/yr Soil rental rate doubled +	Federal, State Aid
CSP	General	Soil, water, air, or plant and animal life improvement. Energy production, including wind, solar, geothermal, and methane production.	Tier I: 5 yrs Tier II,III: 5- 10 yrs	50% New practices 100% Energy	Tier I: Max \$20,000 Tier III: Max \$45,000	Federal
AMA	General	Install wind breaks. Practice organic farming and manage plant diversity. Improve existing dams, irrigation, and pest management.	Life of practice	75%		Federal Aid Max \$50,000 /yr
ICM	Nutrient Management	Assist farmers with creating a nutrient management plan.	4 years		\$6/ acre \$3,000 over 3 yrs	Federal, State Aid Max \$10,000
BMP	Nutrient Management	Installation of manure lagoons to prevent runoff	Length of project	50%		Federal, State Aid Max \$50,000 /yr
AMMTG	Innovation/ Nutrient Management	Innovations to reduce odor, separate liquids, and extract nutrients from waste.	Length of project	Up to 80%		Federal, State Aid Max \$150,000

* New farmers who have been farming for fewer than 10 years, limited resource farmers making less than \$100,000.

† Soil rental rate is decided by the county and is based on soil productivity.



Farm Insurance

By Bob Parsons

CHAPTER VII

FARM INSURANCE

Farms encounter and create risks every day through activities such as owning and renting land, selling products, owning and operating equipment, and hiring employees. Additionally, the act of farming intrinsically holds risks. As a consequence of actuarial information, it is classified as one of the most dangerous occupations as far as work-related injuries and accidents go.

But farm owners and operators can take some actions to lower, avoid, reduce, accept, or transfer the risk to a third party—an insurance company. Nearly all businesses elect to transfer at least part of their risk to an insurance company. But there is always the caveat: the greater the risk, the greater the cost of the insurance. So while insurance can be an option, its cost may be considered as more risk for the business than the protection the coverage provides.

Insurance policies and coverage are confusing topics for most farm business operators. All insurance has one primary function. For a fee, the insurance company will shoulder the risk of an occurrence that could have major repercussions to the financial security of a business.

The major types of insurance include liability, fire, weather conditions, health, Workers' Compensation, life, product liability, and crop. The decision about how much insurance to carry depends on farmers' exposures to risk, their wealth, their willingness to assume risk, and the cost of the insurance. A well-established farmer is generally in a better position than a beginning farmer to withstand a financial loss and afford the insurance that protects against major losses.

Rather than asking about the types of insurance, the level of coverage, and the cost, it's wise to ask:

What types of insurance can the farmer afford NOT to have. Could the farm operation continue if a disaster hit the farm? Could the farm withstand a liability claim, a fire, snow collapsing a barn roof, cattle getting killed by lightning, a crop disaster, or the death of a key owner or manager?

When taking out insurance coverage, be sure to ask questions about likely "what if" situations. As always, the devil is in the details—or the fine print. Press your insurance representative for details and clearly written statements. If you don't understand the fine print terms, ask for clear definitions. If your insurance representative cannot give you definitive answers, you may need a different insurance representative. Remember, you are paying the insurance bill. Make sure you have the coverage and protection you need and seek. Following is a discussion of different types of insurance.

Workers' Compensation

Workers' Compensation insurance relates to labor management and employer responsibilities. By law, all agricultural employers with an aggregate payroll of \$10,000 per year are required to carry Workers' Compensation insurance to provide coverage for injuries and lost wages for all farm workers who are injured while working. Wages include room and board and other non-monetary benefits. Family members who reside in the employer's home may also be excluded. Part-time workers, interns, and apprentices must all be covered. Because farming is considered to be a high-risk occupation, insurance rates are relatively costly for farmers. But the risk of not carrying Workers' Compensation insurance can be greater than paying the insurance cost. Farm operators can be fined for not carrying Workers' Compensation and additionally, the farm owner will be responsible

for any medical costs and lost wages if a farmer is injured on the job. For more on Workers Compensation, see "Workplace Injury – Workers Compensation" in Chapter V on page 106.

Another complication with Workers' Compensation is employing family members, particularly if they are minor children. Are family members considered to be employees and/or are they covered by a family health insurance policy? Some farms attempt to avoid paying Workers' Compensation insurance by forming a partnership, making each family member self-employed. However, if individuals in the partnership don't carry health insurance and become hurt or injured while doing farm work, who pays for their medical care and lost wages or takes care of them if they become disabled? Again, farmers should ask their insurance representative for coverage details as it relates to their personal situations.

Health Insurance

Health insurance is one of the biggest costs for farm operators. In many cases, farmers have to buy individual coverage without the advantage of a large group that can obtain insurance at a discount. As self-employed individuals, they need coverage for accidents or injuries that can occur while on the job. And, given that farming is one of the most dangerous occupations, the cost of health insurance can be

prohibitive for some farm families. But the alternative, facing the task of paying for health care, can be even more daunting.

There are few alternatives to health care. Some low-income families can qualify for state programs for their children or Medicaid for the entire family.

Interns and Workers' Compensation

One complicating issue with Workers' Compensation is the use of interns on some farms. Is an intern an employee if he or she is not being paid? The short answer is that interns are considered employees and need to be covered by Workers' Compensation in case of an injury or accident. Farmers should contact their insurance representative for the coverage costs and the employer's responsibilities before entering into any intern/student relationship.

Disability

As mentioned above, farming is classified as one of the most dangerous occupations. As such, disability insurance presents a major problem for many farmers. In fact, farmers have a greater chance of becoming disabled than dying from a farm accident. Dis-

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FARM INSURANCE

ability can hit the family with a double whammy, eliminating the labor and management skills of a key family member and placing a liability on the family to continue to provide care for the injured family member.

Back injuries; loss of fingers, arms, or legs; eye injuries; knee injuries—all these can leave the primary farm manager/laborer incapable of performing normal tasks. At that point, the farm may have to hire additional labor to compensate for the owner's labor. Many farmers have life insurance but no disability

insurance. They generally forget about the disability insurance, but farmers should consider it a top priority.

Farmers should always keep disability coverage with their Social Security Tax. Social Security provides disability coverage for workers who have worked and earned self-employment income and paid self-employment taxes. To be eligible, workers must earn “credits” based on their earnings. The wages necessary to earn credits vary from year to year and the number of work credits required is a function

of the worker's age. For more on this go to: <http://www.ssa.gov/dibplan/dqualify2.htm>. One common aspect of farming is that the generally low income it gives often eliminates the obligation to pay Social Security Tax. However, all self-employed taxpayers have the option of paying the minimum Social Security Tax. Not only does this increase the individual's ability to collect Social Security at retirement, but more importantly, it also qualifies the individual and his or her dependents as eligible for Social Security benefits in case of disability.

Life Insurance

The advertisement says it all: life insurance is for those left behind, not for the dead. Life insurance can provide necessary money for transferring the farm, covering tax obligations, or paying farm heirs.

Whole life and term insurance are the two general types of life insurance. Whole life insurance lasts a lifetime and can be used as a retirement program or a major source for inheritance. As such, it is more expensive than term insurance. Term insurance is purchased for a certain period of time and provides more coverage per dollar of cost than whole life. But

term insurance becomes increasingly costly as the insured party ages.

The general advice about life insurance is that one should acquire insurance for the time period when it is most needed. For example, young people are likely to need considerable cash to cover family living expenses, the children's education, and outstanding mortgages if the primary provider unexpectedly dies. However, people in retirement who have no mortgage or children's education expenses need much less life insurance.

Life insurance can play a crucial part in preserving or transferring a farm business. For example, an insurance policy for key members of a family partnership can provide the cash to pay potential inheritance taxes, a cash inheritance to non-farm heirs, or buy out a business partner. Similarly, if on-farm heirs insure the life of their parents, this money can become an inheritance source for non-farm heirs. Life insurance has many roles, but it's wise to consider costs in order to get the best protection for matters that cannot be handled by other means.

Crop Insurance

Crop insurance is meant to reduce the farmer's risk from uncontrollable weather conditions that reduce the quality of the crop and/or market conditions that negatively affect the price at which they can sell their product.

Crop insurance is available for a number of crops commonly grown in Vermont. The USDA provides subsidies for companies that sell crop insurance policies to farmers. The subsidies reduce the real rates as much as 65 percent, making crop insurance affordable for farmers.

Crop insurance is designed to reduce production and marketing risks that farmers face as a consequence of natural forces such as drought, floods, hail, disease, and/or insects. Crop insurance programs also have an option for coverage for gross returns to protect the farmer from changes in market prices. These programs are primarily aimed at specific crops such

as corn or apples. There is also a program designed for diversified farming operations that allows farmers to insure their gross farm incomes. This program is called "Adjusted Gross Revenue." Crop insurance is also becoming increasingly available for specialty vegetables and organic crops.

Crop insurance works much like car insurance. Farmers protect themselves in case of a wreck. Just as drivers don't carry 100 percent coverage on their auto or truck, farmers don't either. Instead, they choose an appropriate deductible that they will cover in the event of a disaster.

Farmers purchase crop insurance from a commercial insurance agent. As with car insurance, the higher the deductible, the lower the crop insurance rates. The farmer pays premiums that are much lower than they might otherwise be as a result of the USDA subsidy. Farmers take out a policy that provides cov-

erage for a guaranteed yield or gross revenue. For example, a farmer might want to insure his corn silage yield. The farmer's historical five-year average yield is 18 tons per acre, and he wants coverage for a 75-percent yield—13.5 tons per acre. The other 25 percent, or 4.5 tons, is the farmer's deductible.

In the case of an auto wreck, drivers receive indemnity from the insurance company only for damages above the deductible. In the case of crop insurance, however, farmers must have a "wreck" or a crop loss greater than their "deductible." In the above example, the farmer must incur a loss greater than his 4.5-ton deductible. If the farmer's yield was only 12 tons, he would receive indemnity payments for his insured loss of 1.5 tons, which is the difference between the actual yield (12 tons) and the average yield (18 tons) less the "deductible" of 4.5 tons. The indemnity is based on the 1.5-ton insured loss.

Property Insurance

Most farmers carry some insurance for their buildings, equipment, feed stocks, and livestock to protect against loss from fire, theft, and/or other natural occurrences such as snow fall or flooding. Farmers must decide which items to insure and how much coverage to provide. Some items, such as buildings, are difficult to value because of age, condition, and obsolescence. Farmers also face the challenge of de-

termining whether or not the building should be covered for replacement cost.

Leased land and buildings present additional complications. Landowners and tenants must determine the lines of responsibility. In many cases, the owner is responsible for the buildings, but the tenant is responsible for items in the building such as equipment, feed stocks, and equipment.

Farmers often lower their property insurance costs by limiting coverage on the value of property. In some cases, maintaining coverage on older obsolete buildings or equipment isn't worth the cost, either.

Remember that the farmer has the responsibility of informing the insurance company of any changes in property such as building additions, new equipment, and livestock.

Liability Insurance

Farmers face the risk of liability from several angles. A farmer is liable when his or her inaction or actions result in personal injury or damage to another person or another's property. Liability extends to injuries or damages that result from actions of the farmer's property or employees. Someone who owns land, land, equipment, animals, or who conducts business activities automatically assumes responsibility for any liabilities that occur as a result of any of this property or activity.

Liability as a result of owning land differs according to the status of the person who has come onto the land and is injured there. For example, landowners have minimal obligations to a trespasser, a person who has come on to the property without permission. They owe a greater obligation to someone who comes on to the property as an invited guest. Landowners have another set of obligations to a person who comes on to the property as a customer. For more on landowner liability, see "Landowner Liability Issues in Vermont," on page 78 in Chapter III, Land Tenure and Farm Leases.

Liability covers a range of topics, from damage to another individual's property, injuries to an individual, or actions that can limit another individual's use of property or freedom. The list can be quite lengthy. Liability insurance coverage is available for a price, but it's important to consider special circumstances that may need extra coverage or special consideration. If the farm business includes activities that are

not ordinarily covered in a general farm policy, such as a corn maze open to the public or agri-tourism, a special policy rider may be necessary to ensure complete coverage.

Exclusions

The most important part of any insurance policy is the fine print that describes what is NOT covered by the policy. It's important to go over this important section with your agent. If you ask about a specific activity, which you should, don't accept an answer from your agent such as, "I think you are covered." If there is any question about coverage, request clarification in writing. Remember, what the large print giveth, the fine print taketh away.

Product Liability

Many farms are setting up farm stands. If you do so, you must have liability coverage for customers who come on to your property. As well, you will need to have product liability. This holds true whether you are selling from the farm, at a farmer's market, or to a retail store. If you are selling a food product or raw food, you must be covered against the possibility of food-borne pathogens as well as allergies. Value-added items such as cheese, yoghurt, or preserves must be processed according to accepted methods and meet all federal and state requirements. Selling

products from outside suppliers raises additional liability. Consider all of the implications of assuming liability for products before embarking on this kind of marketing strategy.

Custom Farm Work

Doing custom farm work for other people adds additional risk to a farmer, and these activities may not be covered by your general liability policy. Doing custom work takes you, your equipment, and possibly your employees off your property and onto another farmer's property or the public highway.

Many farmers share work with a neighbor, which adds complicating factors to coverage for both of you. Discuss these activities in depth with your agent to understand the limits of your coverage and whatever liability issues are involved. You may need to consider how much you earn or save by doing this sort of work and balance that against the possible costs of having sufficient coverage for it.

Travel on Roads

Traveling on roads with farm equipment and unlicensed farm trucks to reach parts of your own or your rented property increases your risks. Farm equipment travels at a slow speed and can take up more than half of the road. Many drivers are not aware of the speed of farm equipment and try to

CHAPTER VII

FARM INSURANCE

make unsafe passes. Vermont's narrow and twisting country roads add to the problems. As well, an attached piece of equipment can take up the majority of a rural road and present a hazard to oncoming traffic on blind curves. Make sure you understand your coverage in these cases. If you rarely take your equipment onto public roads, also ask about a discount—you probably qualify for one.

Pollution

Few insurance companies provide coverage for polluting water or air. Farm garbage dumps and leaking fuel tanks are frequent causes of pollution, and if you look around, you'll see many more potential sources such as used motor oil and opened pesticide containers.

The unknown potential damage from pollution is so great that many insurance companies have backed away from providing this coverage. The risk is sim-

The best and least costly method of reducing exposure to liability is to engage in proactive safety programs with family members, employees, customers, suppliers, and guests. Some risks on the farm cannot be avoided, but others can be reduced if you take thoughtful action. For example, bulls are dangerous even under the best

ply too great. In fact, many lenders now request an environmental assessment of farm property before they will provide a farm purchase loan. Expect questions such as: Where are the fuel tanks located? Are there any farm garbage dumps? Have any pesticide containers been dumped on the farm?

Additional activities that are unlikely to be covered include such things as damage to neighboring property from pesticide applications and manure odors. Farmers with manure pits should get clarification on coverage against accidental leakages or dumps.

Farm Recreation: Corn and Hay Mazes

The growing popularity of corn mazes give farmers an opportunity to bring in extra farm income. However, these activities also bring additional responsibilities to the public and expose the farmer to the risk of injuries

Reducing Potential Liability

management. A good risk reduction strategy may be to get rid of the bull—think about it: can the farm get along without a bull? If not, you can make certain to secure the bull well, both inside the barn and in a pasture.

Consider all interactions with the public on your farm. Inspect for any potential hazards.

to visitors. Make sure you have adequate coverage for these activities, but beyond that, take common-sense precautions. Make the area where visitors will be as safe as possible, define the parking areas, and limit the areas where the public can go.

Farm Tours

Many farmers invite school groups to tour their property and visit the animals. You must have strict safety provisions in place when dealing with children because they are attracted to animals, equipment, and interesting places on a farm and lack awareness about possible dangers. A cat scratch, a dog bite, or a pinched hand from a playful calf can all lead to real problems. Make certain your liability coverage is adequate, but again, create as safe a space as possible and limit the areas where the children can go.

Keep shields in place on equipment. Make safety a number one priority instead of just an afterthought. Obtain adequate liability insurance and be familiar with the policy. Know what is covered, what your liability is, and be pro-active about reducing your risk to liability, property damage, and other problems.

Regulation of



Organic Agriculture

By John Cleary



REGULATION OF ORGANIC AGRICULTURE

Organic agriculture is a systems approach that maintains and improves the land through sustainable stewardship. The goals of organic farming are to produce healthful food while reducing pollution, enhance biological cycles to maintain the long-term fertility of soils, and raise livestock in conditions that promote animal health and well-being. Although organic agriculture developed gradually over the past 30 years through the grassroots efforts of small farmers, it is now the fastest growing area of agriculture in the U.S. As the market for these

products began to increase, the need for a consistent definition of this label became apparent.

In 1985, the Northeast Organic Farming Association of Vermont (NOFA-VT) developed organic standards for those farmers who wanted to “certify” to their customers that they were indeed farming organically. Through these voluntary organic standards, the first “certified organic” products started to appear in the marketplace. Although these standards worked well on a local level, increased interstate and international trade of organic products drove the need for consistent national standards.

In 1990, Congress passed the Organic Foods Production Act, which required the USDA to create a National Organic Program (NOP) to develop national organic standards. These federal regulations were designed to be flexible enough to accommodate the wide range of operations and products grown and raised in every region of the United States. The standards finally went into effect in 2002, and now require that all products sold as organic be certified to the national organic standards. The standards are available on line at: <http://www.ams.usda.gov/nop/indexIE.htm>.

National Organic Standards Board

The NOP developed national organic standards and established an organic certification program based on recommendations of the fifteen-member National Organic Standards Board (NOSB). The NOSB is appointed by the Secretary of Agriculture and is comprised of representatives from the following categories: farmer/grower; handler/processor; retailer; consumer/public interest; environmentalist; scientist; and certifying agent. Many

organic farmers and consumers were wary of putting USDA in control of organic standards, but the creation of a standards board made up of representatives from the organic community resolved some of these concerns.

Besides advising the NOP on the ongoing evolution of these standards, the NOSB is responsible for determining what substances are allowed for use on organic farms and what non-agricultural

substances can be included in a processed product labeled organic. This list of allowed and prohibited products is called the “National List” and is available at: www.ams.usda.gov/nop/NationalList/ListHome.html. In an effort to prevent the National List from becoming fossilized, the act specifies a public process for petitioning the board to add a material to the list of products allowable on organic operations.



REGULATION OF ORGANIC AGRICULTURE

Accredited Organic Certifiers

While the USDA controls the regulation of organic agriculture, it does so in partnership with independent organic certification agencies. The USDA accredits certifiers after verifying that they have sufficient expertise and proper procedures in place to consistently and fairly implement the organic standards. Simply put, the USDA accredits the certifiers and lets them run a local certification program without interference. Certified farmers and processors deal only with their local certifier, except in cases where a certification decision is appealed.

Certifiers can set their own fees and application

procedures and in some states, compete with each other for organic producers' business. A complete list of accredited certifiers can be found at: <http://www.ams.usda.gov/nop/CertifyingAgents/Accredited.html#VT>.

Vermont Organic Farmers (VOF), the certification program run by NOFA-VT, currently certifies all of the farms and most of the organic processors in Vermont. VOF's certification fees are on a sliding scale that is based on the gross sales of the operation. They range from \$350.00 to \$700.00. Currently, a federal certification refund program reimburses

farmers for 75 percent of their certification fee.

If you have questions regarding organic certification in Vermont, you can contact Vermont Organic Farmers/NOFA-VT at P.O. Box 697, Richmond, VT 05477, (802) 434-4211, www.nofavt.org, vof@nofavt.org.

Vermont farmers and processors certified by Vermont Organic Farmers may display the VOF logo on their packaging and displays. Besides organic certification, NOFA-VT provides a wide range of production, marketing, and business planning assistance to organic producers.

Certification Process

All organically certified producers and processors must submit an annual Organic System Plan that conforms to the VOF Farm/Processor Production Plan. The plan must demonstrate compliance with the requirements of the NOP standards. Farmers choose the products and enterprises that they want to certify. Provided that they can maintain the integrity of the organic products by preventing co-mingling or contamination, farmers may simultaneously operate a non-organic enterprise. Any qualifying land may be included under the certification, regardless of whether it is owned or leased.

The VOF Plan is a detailed questionnaire that asks the producer to:

- Describe farming or processing practices.
- List all inputs and materials that the farmer or processor anticipates using, including sources, where and how they will be used and why, and documentation on commercial availability as necessary.
- Describe all monitoring practices for pests and pathogenic organisms.
- Describe record keeping system(s) related to the production and sale of organic products, including

fertilizer and spray records, harvest records, sales records, and livestock health treatment records.

- Provide a farm or facility map and description of any organic integrity issues.
- Provide additional information as deemed necessary by the VOF Review Committee.
- Provide a three-year history of each field listing any fertilizer or pesticide applications.
- Provide information about harvesting and handling of products.

The VOF asks farmers to retain a copy of the Farm



REGULATION OF ORGANIC AGRICULTURE

Plan and related records for five years. They rarely verify that you have these records, but can so do if necessary.

The certifier inspects each producer and processor annually. During the inspection process, which generally lasts from two to three hours, the certifier verifies that the producer's information in the application is correct. If the certifier identifies non-compliances, he or she gives the applicant a timeline for coming into compliance with the standards.

Certifiers are responsible for enforcing the

standards and making certification decisions. VOF has a certification Review Committee that is made up of organic producers who have been elected to the committee by the general membership of all certified producers. This Review Committee makes final certification decisions. If an applicant disagrees with a certification decision, he or she has the right to appeal the decision to the USDA. Appeals are handled by the USDA Agricultural Marketing Service Compliance Office and may come before an administrative law

judge. A producer may continue to sell products as organic until the appeal process is completed.

Producers who knowingly sell or label products that do not meet the standards as organic may be subject to a federal fine of up to \$10,000. As well, making a false statement to a certifying agent or NOP official carries a criminal penalty of a fine or jail time or both.¹ The USDA has stated that fines will generally be reserved for egregious cases of fraud. They investigate only situations based on complaints filed with them or the local certifier.

Organic Production and Handling Standards

Under the USDA's National Organic Program standards, any product to be sold, labeled, or represented as organic must be certified. This requirement covers all agricultural producers and handlers with an exemption for those farms with gross organic sales of less than \$5,000 annually. Exempt farms needn't certify but they still must comply with the production and handling requirements of the NOP if they want to sell their products as organic. Exempt producers are also subject to civil and criminal penalties for knowingly selling or labeling products that do not meet the standards as organic. Retail establishments are also exempt from the certification requirement. Some sections of the standard are vaguely worded and can be interpreted different ways. Be sure to check with your local

certifier if you have any compliance questions.

In addition to the specific standards summarized below, all organic products must be produced without the use of genetic engineering, sewage sludge, or irradiation. Producers wishing to become certified should contact their certifier for the complete standards booklet. These national standards are also available at: <http://www.ams.usda.gov/nop/indexIE.htm>.

Organic Crop Standards

Transitioning Fields to Organic Management

In order to be certified organic, crops must be harvested no sooner than three years after the application of a prohibited product, including synthetic pesticides,

herbicides, or fertilizers, unless the product is specifically listed as allowed on the National List.

Buffers

If organic fields are adjacent to conventional fields, they must have adequate buffers to prevent contamination of the organic crop. The required buffer is typically 20-50 feet. If the adjacent field does not pose a contamination risk, no buffer is necessary. The organic standards are process-based and not necessarily a guarantee of purity. A producer must take "reasonable steps" to prevent contamination of organic products, but unintentional environmental residues are not generally monitored.

If organic fields are adjacent to fields growing ge-



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netically engineered crops, a producer may want to take additional steps to prevent cross pollination. While genetic engineering is considered to be an “excluded method,” meaning the organic farmer can’t use genetically engineered products or materials, the inadvertent contamination of the organic crop does not necessarily cause it to be de-certified. However, even if the crop remains certified, organic grain crops are generally tested for contamination by these materials in the marketplace and may be rejected at the mill.

Soil Management

A farm with erosion, pollution, or other conservation problems must demonstrate a program that halts, heals, or corrects the damage.

A producer must select tillage and cultivation practices that maintain or improve the physical, chemical, and biological condition of the soil and minimize erosion.

Crop rotation is required for annual crops and should include cover crops or green manure crops.

Producers must manage plant and animal materials in a manner that does not contribute to contamination of crops, soil, or water by plant nutrients, pathogenic organisms, heavy metals, or residues of prohibited substances. Manure from any source (including conventional farms) may be used. For food crops, manure must be applied at least 120 days before harvesting any crop whose edible portion touches the soil or 90 days before harvesting for crops whose edible portion does not touch the soil. Compost that contains manure and that is planned for application to fields growing food crops must maintain temperatures of

at least 131°F for a minimum of three days and be turned or managed to ensure that all of the feedstock heats to that minimum temperature. Compost produced this way may be applied at any time.

Synthetic, soluble fertilizers are generally prohibited, and natural, mined fertilizers are allowed. For a complete list of allowed fertilizers, contact the NOFA-VT office.

Crop Management

Genetically engineered and chemically treated seeds are prohibited. Organic seeds and planting stock are required if the desired varieties and/or cultivars are commercially available.

Synthetic herbicides are prohibited. Plastic mulch is allowed if removed at the end of the season. Crop rotation and cultivation are the primary weed control tools.

Synthetic pesticides and fungicides are prohibited, unless specifically allowed by the National List. Growers must use management practices to prevent pest and disease problems, including crop rotation, biological controls, traps, and sanitation. When management practices are insufficient, a producer may use biological or botanical substances or a synthetic substance that is included in the National List. Contact NOFA-VT for a list of approved pesticides.

Organic Livestock Standards

Transition Guidelines

Breeding stock meant to produce organic animals for slaughter can be brought onto the farm at any time.

However, if the animals are gestating, they must be brought onto the farm and continuously managed according to organic standards no later than the last third of gestation before giving birth if the offspring are to be considered to be organically produced.

Animals meant to be slaughtered and sold as organic meat must come from breeding stock that has been managed organically from the last third of gestation and was under continuous organic management until slaughter. That is, if an animal was ever managed non-organically, it cannot be sold as organic meat, except in the case of poultry, as described below.

Poultry intended for slaughter or egg production must be under continuous organic management beginning no later than the second day of life.

Dairy animals must be under continuous organic management no later than one year before organic milk production. When transitioning an entire herd to organic management, the following feed exception applies:

- For the first 9 months of the year, farmers can feed up to 20 percent non-organic feed. The remaining 80 percent must be organic.
- For the final 3 months, farmers must feed their transitioning herd 100 percent organic feed.
- After the initial transition, all animals must be under continuous organic management.

Due to recent litigation,² it appears that the dairy herd transition standards will be changing. The new standard will require dairy herds to consume 100 percent organic feed for the entire 12



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month transition period. While this will dramatically increase the cost of transitioning to organic, the organic milk processors have responded by offering farmers funding to cover some of these costs if the farmer agrees to ship to them. In addition, some NRCS programs are prioritizing the funding of organic transition projects and can provide modest per-acre payment to farmers going through a 3-year transition to organic.

Housing

Livestock farmers must provide the following, based on the species' natural behavior:

- Housing that provides access to the outdoors, shade, shelter, exercise areas, fresh air, and direct sunlight as appropriate to the species, stage of production, climate, and environment.
- Access to pasture for ruminants.
- Appropriate clean, dry bedding.
- Management of manure so it does not contribute to the contamination of crops, soil, or water and optimizes recycling of nutrients.

Feed

Livestock must receive 100 percent organic feed.

Feed additives and supplements are allowed if consistent with the National List; in general, natural substances are allowed, and a limited number of synthetics are allowed. All FDA-approved vitamins and minerals are allowed, including synthetic forms.

Mammalian or poultry by-products such as animal fats and rendered products are prohibited in feed.

Pasture requirements include the following.

- Ruminants must have daily access to pasture during the grazing season.
- Pastures must be managed in a way that prevents erosion or water quality problems. Fenced riparian buffer zones are recommended along waterways to stabilize banks, reduce runoff and erosion, and provide wildlife habitat.

Livestock Health Care

Producers must use preventative health care practices, including:

- Providing feed sufficient to meet the needs of the animals.
- Establishing appropriate housing, pasture, and sanitation to reduce diseases and parasites.
- Providing animals with the opportunity for exercise, freedom of movement, and reduction of stress.

When preventative measures are insufficient to prevent sickness, producers may consult the National List and the VOF Health Product List for allowed medications.

Producers must keep written records of all health substances administered to any animal.

The following practices are prohibited:

- Administering any animal drug in the absence of illness.
- Using hormones for promotion of growth of

livestock.

- Selling as organic any products from animals that have been treated with antibiotics.
- Withholding treatment from animals to maintain organic status.

Slaughter

All animals must be slaughtered at a certified organic slaughterhouse. Producers are responsible for maintaining records showing which animals were processed and their organic status and ID number. Animals must be treated humanely during loading, unloading, shipping, holding, and slaughter. Contact NOFA-VT for a current list of organic slaughterhouses.

Organic Processing Standards

Organic Control Points

The essence of the organic processing standards is to insure that the integrity of the organic ingredients is not compromised during the processing of the product. The producer should identify any organic control points where there is the potential for organic products to be contaminated with prohibited products or co-mingled with non-organic products.

Ingredients

Organic ingredients must be certified to the USDA standards and verification of this provided to the certifier. Ingredients produced with the use of genetic engineering, sewage sludge, or ionizing radiation are prohibited from use in organic processed



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products. Any non-agricultural ingredients must be listed on the National List.

Labeling

All labels must indicate the certifier of the product. Organic processed products may only be labeled in one of the following ways.

Products labeled as “100% Organic”. Products represented as 100% organic must contain 100 percent organic ingredients. They may be labeled anywhere on the package as “100% organic” or “organic.” Processors may use the USDA Organic Seal and the VOF logo.

Products labeled as “Organic”. Products represented as “organic” must contain at least 95 percent organic ingredients, and the remaining ingredients must also

be organic unless they are not commercially available organically. The remaining ingredients may also be non-agricultural substances such as additives and processing aids that are on the National List. Processors may use the USDA Organic Seal and the VOF logo.

Products labeled as “Made with organic [specified ingredients]”. Products sold as “Made with organic...” must contain at least 70 percent organic ingredients. The processor may not use the USDA Organic Seal or VOF logo.

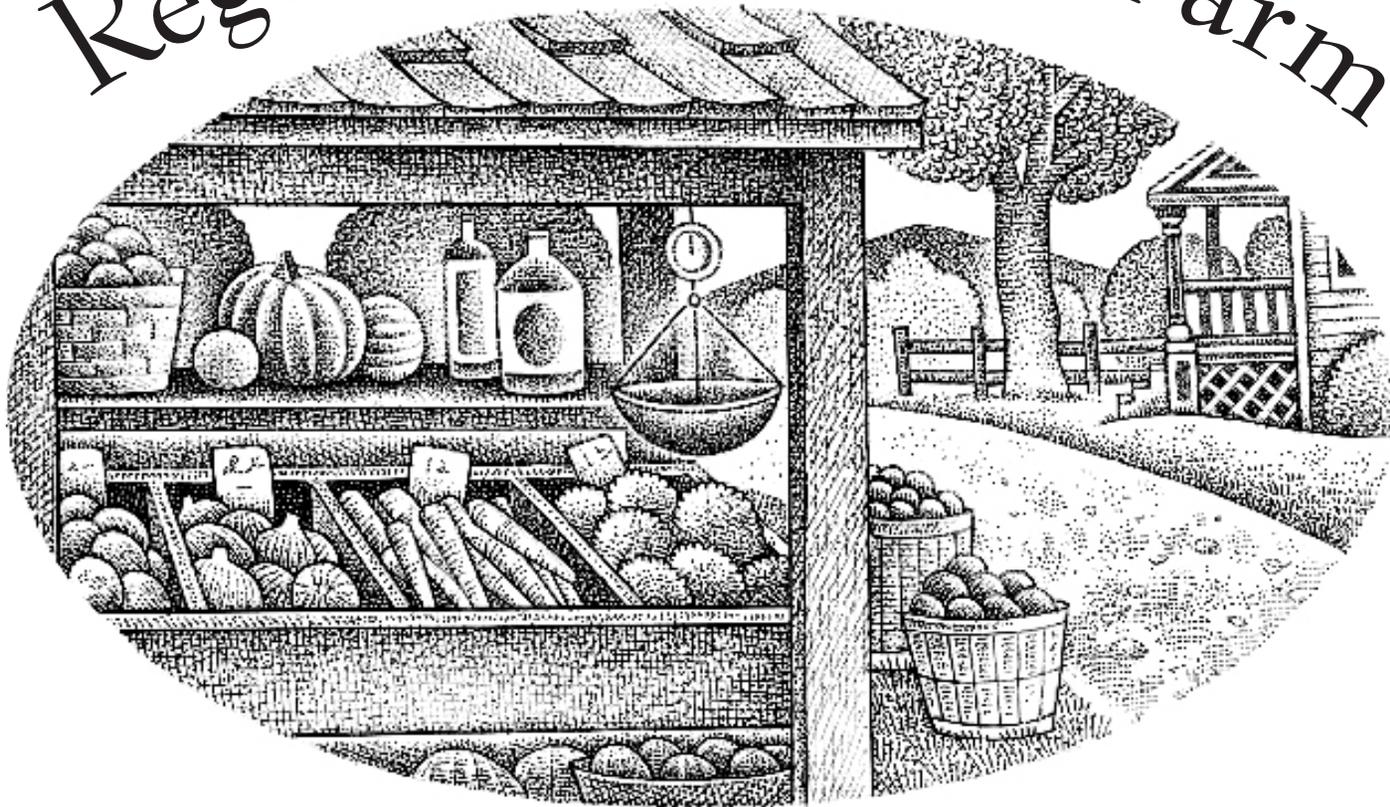
Record Keeping

The processor must have a record keeping system that is appropriate for the type of operation but that allows the tracking of all raw ingredients through

processing and to the final product. An inspector should be able to pick up a finished product and trace back the certified ingredients that went into it as being from a specific supplier. Other records may be required to demonstrate compliance with the standards, including such things as the pest control log and the equipment cleaning records.

These national organic standards are relatively new and the interpretation of them continues to evolve. The USDA National Organic Program relies on an advisory board, the National Organic Standards Board, and the public for input to the program. NOFA-VT is also very involved in the ongoing dialogue about how these standards should develop.

Regulation of On-Farm



Food Processing and Marketing

By Brian Norder



REGULATION OF ON-FARM FOOD PROCESSING AND MARKETING

Introduction

Increasing numbers of farmers and growers are turning to on-farm food processing as a means of improving their bottom line. But long before they

hammer the first nail for the processing room or produce their first commercial batch of cheese or jam, farmers must understand that they are entering a new

regulatory environment. This chapter discusses on-farm food processing and marketing and identifies the agencies and regulations that govern these activities.

Overview of Agencies Overseeing Food Production and Marketing

Both federal and state agencies have a role in overseeing food processing facilities and techniques.

The Federal Food and Drug Administration (FDA) – Food Processing

The US Food and Drug Administration (FDA), oversees much of the nation's food supply as well as drugs and medical devices. This agency is also responsible for interpreting the law and writing regulations concerning specific food products and processes. It's helpful to recognize that regulations regarding food processing are not "black and white" and are subject to the interpretation of the individual regulators. The "grey" area becomes even more pronounced when it

comes to on-farm food processing.

Rules and regulations established by the FDA are published in Title 21 of the Code of Federal Regulations (CFR) which can be found at: <http://ecfr.gpoaccess.gov>. These laws are intended to assure that foods are safe to eat, pure, wholesome, and produced under sanitary conditions.

In the aftermath of the attacks of September 11, 2001, Congress passed the Bioterrorism Act (BTA) of 2002, parts of which are designed to help protect the nation's food supply from attack. Regulations written to implement parts of BTA 2002 make it clear that we are in the midst of the most sweeping overhaul of food regulations since the Food, Drug and Cosmetics Act (FDCA) of 1938.

FDA inspectors have the authority to inspect any establishment where food is processed, packaged, or

held for shipment in interstate commerce. They can also inspect products after shipment, vehicles used to transport food in interstate commerce, equipment, finished products, containers, and labeling. The FDA's definition of interstate commerce is so broad that if a food is packaged in material that comes from a different state, the food is under the jurisdiction of interstate commerce regulations.

The FDA can affect a large range of on-farm processing activities. Areas of particular interest to the agency include cheese, particularly any made from aged milk, and acidified foods, such as pickled products, salsa, and chutneys. The FDA believes that raw milk cheese has a high risk of bacterial contamination and deserves close scrutiny. Improperly prepared and canned acidified foods are at risk for growth of *Clostridium botulinum* which causes botulism.



REGULATION OF ON-FARM FOOD PROCESSING AND MARKETING

Research and scientific debate are on-going regarding the safety of raw milk cheese. It must be noted that the safety of consuming cheese made from raw milk and the safety of consuming raw milk are different issues in terms of their respective hazards and relative risks.

US Department of Agriculture (USDA) – Meat and Poultry

The United States Department of Agriculture-Food and Safety Inspection Service (USDA-FSIS) is the agency that enforces laws pertaining to meat and poultry. Meat and meat products derived from cattle, sheep, swine, goats, and horses are subject to the provisions of the Wholesome Meat Act, and poultry is subject to the Wholesome Poultry Act. Food products having more than three percent (3%) raw meat or two percent (2%) cooked meat are subject to USDA regulations and must be produced in a USDA-certified facility.

The Food and Safety Inspection Service maintains regulatory authority over most meat and poultry products consumed in the United States. Some states, Vermont included, have their own meat inspection programs for meat and poultry products strictly involved in intrastate (within the state) commerce. Only USDA-inspected meat and poultry products can enter into interstate (outside the state) commerce.

Vermont Agency of Agriculture – Milk, Meat, and Poultry and the Vermont Brand

The Vermont Agency of Agriculture, Food and Markets has primary responsibility for inspecting dairy processing as well as meat and poultry processors that are operating under the state grant of inspection.

The Agency is also responsible for overseeing compliance with maple regulations and for accuracy of weights and measuring devices used for commerce. The Consumer Protection Section of the Agency conducts random inspections of food products to ensure that the weight or content statements on labels are accurate and also reviews labels for food producers for regulatory compliance.

The Vermont Seal of Quality program allows producers to use the Seal, which designates that the food was made from Vermont ingredients or was processed in Vermont. Applications for this program are available through the Agency.

Vermont Department of Health – Jams, Jellies, and Baked Goods

The Food and Lodging Division of the Vermont Department of Health is responsible for a wide range

of licensing and inspection activities. In some cases, these activities are governed by state law and in others, the Health Department conducts inspections under contract with the FDA to assess compliance with federal regulations.

The Health Department issues Food Processor licenses for shelf-stable foods such as jams, jellies, sauces, beverages, and pickled products. They issue three separate classes of licenses and regulations for baked goods – home bakery, small commercial, and large commercial. A farmstead bakery will fall into one of the first two categories. Home kitchens with non-commercial equipment are eligible for the home bakery license. A farm-based, small commercial kitchen would need a dedicated space and commercial baking equipment.

Bureau of Alcohol, Tobacco and Firearms (BATF) - Beer, Wine, and Hard Cider

The BATF, or ATF, a division of the US Treasury Department, licenses and oversees production and collection of taxes on beer, wine, hard cider, and liquor. Prospective alcoholic beverage producers face a lengthy and rigorous application and licensing process. Manufacturers are required to maintain detailed production records for excise tax determination and submit these on a regular basis.



REGULATION OF ON-FARM FOOD PROCESSING AND MARKETING

Food Safety Systems

Every major outbreak of food-borne illness is intensively covered by local and – depending on severity – national media. This is definitely not desirable publicity. Additionally, there are likely to be costs associated with such an outbreak: medical bills, lawsuits, and increased insurance premiums. It's important to realize that an operation can comply with all regulations, operate legally, and still have food safety problems. For that reason, it's imperative to incorporate food safety systems into all processing operations. We will look at Good Manufacturing Practices (GMPs), Good Agricultural Practices (GAPs), and Hazard Analysis and Critical Control Points (HACCP).

Good Manufacturing Practices

The term Good Manufacturing Practices (GMPs) actually has two meanings when used in the context of a food processing facility. The first refers to actual federal code sections of GMPs (<http://www.cfsan.fda.gov/~lrd/cfr110.html>), and the second is a set of operating procedures based upon those codes. The actual codes provide the basis for both federal and state food processing regulations that serve as guidance for facility construction, equipment and utensil selection, sanitization, personnel hygiene, food handling, and production and processing controls.

While these GMPs are fairly generic, this section of codes is quite readable and provides, in a few pages, an excellent overview of most facets of sani-

tary facility operation. Once understood, a facility operator can use these codes as a basis of a written GMP program. A typical GMP program consists of several parts, each of which has a written set of policies and a checklist based upon those policies. Often, policies and checklists are combined into one document. For example, many plants have pre-operational or “pre-op” policies in place. A supervisor or responsible person conducts a pre-op check before the day's production begins and notes corrective actions taken to correct deficiencies.

A written GMP program should also include sanitation and pest control policies and documentation. The sanitation program should include information about the cleaning chemicals used in the plant, how they are handled and stored, and how Material Safety Data Sheets (MSDS) are maintained. Additionally, the sanitation program should detail weekly, monthly, and periodic cleaning schedules and how that cleaning is to be conducted, monitored, and recorded. The pest control program should be developed in conjunction with a professional pest con-

Example of a Pre-op Checklist

Pre-operational Policies – Whistling Woods Farm Cheese Plant

(Check if correct, x if deficient, and note corrective action)

- All equipment and food contact surfaces are clean, free of visible contamination, and sprayed with sanitizer prior to use.
- Sanitizer strength tested at between 75 & 100 ppm.
- Chemicals and toxic materials stowed prior to production.
- Refrigeration equipment at 37° F or below. (Record temp. _____)

- Freezer at 0° F or below. (Record temp. _____)

Processing thermometers calibrated by: (initial _____)

- All personnel in clean uniforms; hairnets; without jewelry or long or false nails; hands properly washed.

Corrective actions taken: _____



REGULATION OF ON-FARM FOOD PROCESSING AND MARKETING

trol operator who will assist in recordkeeping and in making facility recommendations that will help to exclude pests and reduce harborage areas.

Another part of a written GMP program should be based on the section “Production and Process Controls.”¹ Under “Production and Process Controls,” your plan should address means of preventing contamination of the food you are producing, processing time, temperature controls, and other critical factors such as moisture, salinity, acidity, and so on. You must also have a means for lot coding each batch of product so that you can issue a recall, if needed.

It is important to note that the FDA is currently undertaking a major overhaul of GMPs. In addition to changes in regulations due to the Bioterrorism Act of 2002, these GMP revisions will significantly tighten documentation procedures. While these changes will not be effective until a date yet to be determined, the more work a producer does at present to set up record-keeping systems, the less work will be required for future compliance.

Good Agricultural Practices (GAPs) for Fresh Fruits and Vegetables

Good Agricultural Practices, or GAPs, are to farm production what Good Manufacturing Practices are to food processing. While GAPs aren’t codified to the extent of GMPs, they are widely accepted and practiced.² GAPs are designed to reduce microbial contamination of fruits and vegetables. GAP stan-

dards have been developed by a consortium of land grant colleges and serve as voluntary recommendations. General GAP guidelines are available on line at: <http://www.foodsafety.gov/~dms/prodguid.html>.

GAPs are designed to make food safer by helping farmers address areas that are most likely to create hazards. Only in the past decade or so have hazards associated with fresh produce been widely understood and publicized. A food safety program based upon Good Agricultural Practices can help minimize microbial and chemical contamination and reduce the risk of food-borne illness.

“Key areas of concern when implementing a GAP program are prior land use; adjacent land use; water quality and use practices; soil fertility management; wildlife, pest, and vermin control; worker hygiene and sanitary facilities; and harvesting and cooling practices.”³

Producers should recognize that contaminants exist in soil, water, and on fresh foods and that even a GAP program cannot change this fact of life. What GAPs can do is help identify the organisms and chemicals that present a health risk and inform people about ways to minimize their presence.

The history of the land can help identify potential hazards. For example, land that was grazed with cattle for a length of time can harbor high microbial loads, while prior pest and soil management practices could have left dangerous chemical residues behind.

Understanding the nature of pathogenic organisms can help in assessing the hazards a GAP program can address. Most organisms of concern origi-

nate in the intestinal tracts of humans and animals and are transferred through soil, water, by human contact, or through a combination of these factors. The following describes each means of contamination and appropriate control measures.

Soil. Animal waste from wild animals, pets, and/or cattle is a major hazard and measures to exclude these wastes from crop areas should be considered. Drops from apple orchards have “fallen” from favor in recent years because we now understand the risks from deer droppings. Organic fertilizers such as manures, post-harvest materials, and organic wastes play a major role in agriculture but are not without risks. Assessing these risks is a crucial part of developing appropriate GAPs.

Water. Because so many agricultural processes rely on water, this is an area of major interest in formulating a GAP plan. Irrigation, vegetable washing, cooling, hand washing, and refreshment for workers are among the roles that water plays on a farm. While the Environmental Protection Agency issues standards for drinking water, they do not apply to agricultural water. A GAP plan addresses possible sources of contamination and the hazards of various types of contaminants. Upstream and upslope sources of contamination must be analyzed for their impact on agricultural uses and corrective steps taken as necessary.

Human contact. Proper personal hygiene is important to guard the safety of agricultural products. Frequent outbreaks of Salmonella out west have been traced to workers’ contaminating the outside



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of melons during harvest. This contamination occurs, in large part, as a result of poor hand washing after using the bathroom. The bathroom in fields frequently consists of “porta-potties” with no hand washing facilities. In its efforts to reduce risks, the FDA is paying increased attention to field worker hygiene. A worker hygiene policy is an important part of a GAP program.

Hazard Analysis and Critical Control Points (HACCP)

HACCP (pronounced has-sip) is a widely recognized system for increasing safe food production. A HACCP program is designed to identify the steps within a food process that contain the greatest hazards, identify scientifically validated steps that can reduce these hazards to an acceptable level, insti-

tute these control measures, and document their use and effectiveness.

Currently, HACCP is mandated only for state or federally inspected meat and poultry processing plants, as well as seafood and juice processors. It is likely that other categories of food processors will require HACCP plans over time. In addition, many customers of food processors such as distributors, retailers, and institutional feeders are beginning to require that all their suppliers operate under HACCP.

Developing and implementing a HACCP plan requires a major commitment of time, money, and effort. It is important to recognize that the HACCP plan only works if so-called pre-requisites are in place. Those include an effective cleaning and sanitation program and documented GMPs. Poor sanitation or the failure to follow GMPs will render a HACCP plan ineffective. A HACCP program

is not designed to compensate for generally poor practices but rather to use solid practices as a basis for a food safety program that can provide the highest assurance of safety.

Short of implementing a HACCP program, food producers can gain a basic knowledge of HACCP on-line or through written material. This basic knowledge can be used to understand the hazards associated with a given food even without implementing a HACCP plan.

A HACCP plan that is developed by an unqualified individual, or one that is incomplete, not scientifically valid, or simply not followed could possibly present greater liability issues in the event of a food-borne illness than no program at all. As stated before, HACCP requires a major commitment. Properly done, it is excellent safety system, but there are no shortcuts.

Regulations for Specific Commodity Types

A number of state and federal agencies have regulatory authority over food processing. The complexity of the regulations and the level of regulatory oversight for specific commodities is directly related to their relative food safety risk. Meat, poultry, and dairy processing have the greatest risks, so they are tightly regulated. Baked goods, maple sugar, honey, fruit, and vegetable processing are less hazardous and thus, the compliance is easier.

Meat and Poultry

The US Department of Agriculture or the Vermont Agency of Agriculture, Food and Markets inspects meat and poultry products. Processing operations are classified as exempt, custom, and full, or amenable, and the level of regulation increases at each step. In many cases, state inspectors conduct federal inspection under contract with the USDA.

Full – or amenable – inspection is the most rigorous of the inspection programs and requires a very detailed and well documented HACCP plan. Meat and poultry products that will be re-sold directly to consumers or through retail or wholesale channels must undergo this inspection process. As well, a producer must have a distributor’s license before selling meat or poultry that was processed under inspection to either wholesale or retail outlets.



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Vermont law allows on-farm processing of up to 1,000 birds, including ratites (ostrich, emus, and rhea) to be exempt from facility requirements, provided all the birds were raised on the farm and sold directly to consumers. Farmers who sell birds at farmers' markets or who sell 1,000 to 20,000 birds directly off the farm to consumers are required to have facilities that meet certain sanitary standards. The facility must undergo an annual registration and periodic inspection with the Vermont Agency of Agriculture, Food and Markets and operate under a HACCP plan. All the birds must be sold as whole carcasses. A "Handbook for Exempt Poultry Processors" is available through the Meat Inspection Section.

Only poultry processed at a fully inspected facility may be sold to restaurants or retail stores, and the seller must obtain a wholesale distributor's license from the Agency.

Meat from animals slaughtered on the farm can be consumed by farm owners, employees, and non-paying guests.

Custom processing is limited to butchering game or slaughtering and processing poultry, ratites, beef, swine, sheep, and veal for personal consumption and not for re-sale. A grower may sell a live animal to a consumer and deliver that animal to slaughter. The consumer is responsible for the slaughter expense and takes possession of the meat at that point.

A producer may sell whole, half, or quarter carcasses by hanging weight if the animal was slaughtered under inspection and the producer relinquished

control of the product to the buyer at that point. The producer does not need a distributor's license for this activity.

Any person considering on-farm meat processing should contact the Meat Inspection Section of the Vermont Agency of Agriculture at (802) 828-2426.

Dairy Products

The Vermont Agency of Agriculture carries out most licensing and inspection of dairy products, although the US Food and Drug Administration has jurisdiction of dairy products involved in interstate commerce. While the state remains the primary inspection agency for dairy products, this is an area of increasing interest for the FDA, and FDA inspectors may visit on-farm dairy processing plants.

The federal Pasteurized Milk Ordinance (PMO) forms the basis of the inspection process. The PMO, along with GMPs, can give you necessary guidance for most dairy processing activities.

State officials prefer that potential dairy processors take a pro-active approach in working with them and like to be involved from the earliest stages of plant design. Typically, the Dairy Section Chief meets with potential processors to discuss the regulations, facility design, and safety concerns for their particular product. The risks associated with dairy products dictate that all producers have an understanding of the microbiological hazards associated with their particular foods.

For an example of permits required of a dairy operation, please see "On-Farm Cheese Processing in Vermont" on page 148.

Maple Products

Most of the responsibility for regulating maple products lies with the Agency of Agriculture. The Agency looks at issues of safety, purity, quality, and origin when regulating the maple industry. The province of Quebec has a large maple industry that can ship less expensive product to Vermont. As a result, the Agency and the Vermont Attorney General's office pay close attention to origin and labeling of maple products to protect the Vermont brand and image.

Inspections for safety look at the use of cleaning chemicals, lead in evaporators, food-grade plastic tubing, Good Manufacturing Practices, and the proper syrup concentration. Syrup concentration also affects quality, and the department conducts a voluntary grading program utilizing Vermont's syrup grades, which are more stringent than federal grades.

Foods for which maple is an ingredient, including items such as maple-covered nuts and maple-flavored salad dressings, fall under the jurisdiction of the Health Department for safety and licensing. If a labeling claim is made regarding Vermont origin or grade of the ingredient syrup, Agency of Agriculture scrutiny is possible with fines of up to \$5,000.00 and a year in jail for violations.



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Honey

Due to its low moisture content, honey is not considered a potentially hazardous food and receives little regulatory attention. The Agency of Agriculture licenses and inspects apiaries but is more concerned with controlling the spread of bee diseases than inspecting the honey. Nonetheless, honey should be processed and packaged in accordance with GMPs.

Fruits and Vegetables

The amount of processing that fresh produce receives dictates how much regulatory attention it attracts. Handling, washing, chilling, storage, and packaging

operations should follow GMPs and GAPs, but as noted above, require little or no licensing. If fruits and vegetables are turned into pickles, jams, or jellies, they fall under the FDA and Health Department. Annual sales of under \$10,000.00 are exempt from Health Department licensing but still must follow FDA regulations.

Products such as pickles, dilly beans, chutneys, and salsas fall under specific regulations that can be found in the Code of Federal Regulations (CFR) 21 Part 113. Note that low-acid foods such as canned green beans and similar items that do not contain an acidifying ingredient such as vinegar cannot be processed at home and sold directly at farm stands or at farmers' markets.

Fruit juices also fall under specific regulations.

They must be processed under a HACCP program that includes a means of reducing the microbial load by what is known as a 5-log (100,000) reduction in the number of organisms per gram of product.

Baked Goods

Vermont law allows home-baked foods to be sold either directly to consumers at farmers' markets or at retail outlets without licensing and inspection if the weekly sales volume does not exceed \$125.00. Home or farmstead bakers exceeding this amount can apply for a home bakery or small commercial bakery permit, both of which are less onerous than food processor licenses.

Federal Regulations Pertaining to Food Production and Marketing

The Bioterrorism Act of 2002

The federal Bioterrorism Act (BTA) is driving the most significant changes in food regulation in over half a century. (<http://www.fda.gov/oc/bioterrorism/bioact.html>) In addition to general guidance about food processing plant security, there are three distinct sets of regulations with which processors must comply:

- Registration of food facilities,
- Record-keeping and product tracing, and
- Prior notification of food imports.

Registration of Food Facilities

In brief, many facilities that process, store, or ship food for human or animal consumption are required to register with the FDA. First, a person must establish, at no cost, an on-line account at www.cfsan.

fda.gov/~furls/ovffreg.html. Once an account is established, a person can register his or her farm or company, register on behalf of others, and edit the registration information.

The regulation includes a large number of exemptions for farms. Unfortunately, some activities that have traditionally been considered as "farming" are not exempt. For example, gathering maple sap is considered a harvest activity and is thus exempt.



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But boiling sap is considered processing and is not exempt. However, if the boiling occurs in a garage or detached garage, which is considered as part of a home, it is exempt from registration under the home processing provisions.

Some examples of exempt and non-exempt agricultural activities include the following.

- Feed stored for use on a farm is exempt, but commercial feed dealers and transporters must register.
- Seed grown for cultivation of plants is exempt from registration requirements.
- A packing shed that is located on the farm and packs only produce grown on that farm is exempt. However, a packing shed that services multiple growers must be registered.

The FDA registration website noted above has an entire section devoted to questions and answers about registration and exemptions. If you have any doubt about the need to register a farm, consult that website: www.cfsan.fda.gov/~furls/ovffreg.html.

Record-Keeping and Product Traceability

The BTA 2002 regulations regarding record-keeping and product traceability are clearly the most complex and far-reaching of the three main program areas. Based on its risk assessments, the FDA has determined that to the greatest degree possible, food products should be traceable from “farm-to-consumer.” Meat and poultry products under USDA

inspection are not covered by this regulation.

While there are exemptions for farms and farm products, these exemptions are very narrowly defined. For example, an orchard that sells its apples wholesale is exempt, but the exemption does not apply if the orchard also waxes the fruit – a common practice.

The FDA has published a guidance document that summarizes the recordkeeping and traceability requirements at <http://www.cfsan.fda.gov/~acrobat/fsb>. The area that most affects producers is the requirement for product traceability systems. Producers will be required to trace ingredients one step backward in the food chain and tie the ingredients to finished products one step forward in the chain if the products are being sold through retailers or wholesale distributors. Sales directly to consumers

are exempt from the “one step forward” provision.

Prior Notification of Food Imports

Of the three specific regulations under BTA 2002, the rules regarding prior notice of imports have the least impact on farm-based processors. The FDA now requires advance notification that foods, other than those for personal consumption, are to be imported into the U.S. Companies or individuals that engage in frequent food importing may find it worthwhile to become familiar with the electronic prior notification system, <http://www.cfsan.fda.gov/~pn/pnoview.html>. If import activities are infrequent, it is probably more practical to either use an import broker or have the foreign supplier conduct the FDA notification.

Traceability Example: Whistling Woods Farmstead Cheese

Whistling Woods Farm is a well respected producer of cheddar cheese with an outstanding record of quality and safety. One day, the company received a call from the supply wholesaler saying that rennet from Acme Rennet Co., lot # 0421, had been recalled due to suspicion of tampering. The FDA had ordered all cheeses made from that rennet recalled. Cheese maker Sally Goatsworthy checked her records and determined that the batches made from March 12 to April 19 used rennet from that lot. She knew that much of that cheese was still aging at her farm and was able to isolate that product. However, some cheese was sold at farmers’ markets and she

had received no complaints on those sales, which was reassuring.

Finally, her records indicated that she shipped to Cheesehead Distributors in New Jersey and two retailers in Boston. She contacted the distributor, and that company shipped back the cheese it had in inventory and contacted its retail accounts to recall the Whistling Woods cheese. The Boston retailers returned the cheese they had not yet sold and received credit on it. Because her lot systems were effective, she was able to keep the recall to a minimum and reduce the financial loss to her operation.



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Agricultural Activity or Food Processing?

Certain activities involving food handling are classified as farming activities and are therefore exempt from many of the BTA 2002 regulations governing food processing. Washing, trimming, and re-packing fruits and vegetables in a packing shed clearly meets the definition of a farming activity, for example. However, exemptions from certain regulations do not always mean exemption from FDA Bioterrorism registration, and vice versa, as the following examples illustrate.

The FDA defines manufacturing/processing as “making food from one or more ingredients or synthesizing, preparing, treating, modifying, or manipulating food, including food crops or ingredients.” Please see “Farming or Processing? The Case of Lazy River Vegetable Farm” that illustrates several scenarios for a grower of cabbage and carrots who wants to add value by packing them for cole slaw.

The Vermont Department of Health is likely to be the best source of whether an activity meets its criteria of licensable processing, so farmers should consult them before starting construction on a processing facility or actual processing.

Remember that exemption from formal licensing does not excuse producers from following the provi-

sions of Good Manufacturing Practices (GMP’s) and Good Agricultural Practices (GAP’s) for safe food handling and processing. (GMP’s and GAP’s are

discussed in “Good Manufacturing Practices” and “Good Agricultural Practices for Fresh Fruits and Vegetables” on pages 140 and 141, respectively.)

Farming or Processing? The Case of Lazy River Vegetable Farm

Larry Cole grows a variety of vegetables on his farm and like many Vermont growers, does especially well with cabbage and root crops. He thought he could improve his profit margins and attract new customers by packaging trimmed, peeled, and washed carrots and cabbage together for people to make into cole slaw. This would qualify as an agricultural activity and be exempt from FDA registration and Vermont licensing. Trimming, peeling and washing do not change the basic structure or form of the product, they simply make the appearance more palatable.

But Larry decided that the product needed additional appeal, so he decided to produce and sell a slaw mix that was fully shredded and ready for the consumer to mix with dressing. Because this substantially changes the form of the produce, it is classified as “processing” for the purpose of FDA registration but is unlikely to require a license from the Vermont Department of Health.

Based on the success of this mix, Larry decided to market fully prepared “Lazy River Farms Cole Slaw” by adding his family’s secret recipe for dressing. Because this product mixes farm

and non-farm products, he clearly needs state Health Department licensing as a food processor and FDA registration.

As the examples above demonstrate, the FDA and the Vermont Department of Health have different definitions of regulated food processing activities, with the state’s definition being narrower in scope. The Department of Health considers an activity as licensed food processing only if it entails cooking raw ingredients or combining raw agricultural products with other, non-farm, ingredients.



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Essentials of Food Labeling

The label on a food product serves regulatory, educational, and marketing functions. The entire Food Labeling Guide from the FDA is available at the web site www.cfsan.fda.gov. While this guide is over 100 pages long, a very good summary is available through the web site of the Colorado Department of Public Health at <http://www.cdphe.state.co.us/cp/wholesalefood/labsum.html>.

At a minimum, the label must have a statement of identity—cheddar cheese, peanut butter, hot pepper sauce — in plain language, state the net weight or contents, list the ingredients in descending order by weight, and give the company name and address or phone number. The Food Labeling Guide lists the specific details that each of the four required elements must contain.

The Nutrition Facts panel is optional for small businesses but is mandatory if the label contains any health claims. Again, the Food Labeling Guide goes into great detail on the exemptions and requirements

for Nutrition Facts.

The UPC, or bar code, for register scanning is optional. There is a one-time fee of \$750.00 and annual renewal fees for inclusion in the national data base for the UPC. If you want your product to have broad distribution through larger retailers, consider including the UPC on the label. If your product is not yet ready for this expense, you can wait and add it later. Call the Uniform Code Council at 937-435-3870 for information about bar codes.

The “Vermont” Brand

The state Attorney General’s office developed the Vermont origin regulations that took effect in January of 2006. You can find the rules at: [http://www.atg.state.vt.us/upload/1129038629_Rule_CF120 - Adopted_Rule.pdf](http://www.atg.state.vt.us/upload/1129038629_Rule_CF120_-_Adopted_Rule.pdf).

Only processed or unprocessed food items that are considered a “Vermont product” may carry an unqualified representation of Vermont origin in com-

munications with consumers. An “unqualified representation,” for example, might include “Vermont Apples” or “Vermont Cheddar Cheese” or “Vermont Sweet Corn” as opposed to representations which are “qualified” by terms such as “made with Vermont apples” or “Made in Vermont.” **A food product is considered a “Vermont Product” if:**

- The company is based in Vermont, meaning that the company discharges “substantial functions” in Vermont,
- If processed, the product is substantially transformed in Vermont, AND
- Its primary or prominently identified ingredient comes from Vermont.

The rules on “qualified” representation require that the representation be accurate and that the qualifying language be just as prominent as the word “Vermont.” The rules also cover the use of “Vermont” in the company name. ⁴



REGULATION OF ON-FARM FOOD PROCESSING AND MARKETING

Case Study: On-Farm Cheese Processing in Vermont

By Marne Coit

On-farm cheese processing is an increasingly popular farm income diversification strategy in Vermont. The Vermont Cheese Council, a trade organization of cheesemakers in Vermont, currently numbers more than thirty members. Members produce a variety of cheeses, including hard and soft cheeses made from cow, sheep, goat, and water buffalo milk.⁵

Artisanal cheeses with Vermont branding have the potential to add significantly to Vermont's farm income. However, the investment necessary to make cheese on the farm can be substantial. The cost of constructing or upgrading milk-handling facilities to comply with the Pasteurized Milk Ordinance (PMO) can run into the tens of thousands of dollars. The cost to start a new cheesemaking facility can cost between \$50,000 and \$100,000. The penalties for non-compliance are severe.

Pasteurized Milk Ordinance (PMO)

The federal government, under the Food and Drug Administration, has established the Grade 'A' Pasteurized Milk Ordinance (PMO). The PMO was established as a model regulation that could be adopted by individual states. The purpose behind it is to encourage uniformity of sanitary standards for the handling and production of milk and milk products. It applies to Grade "A" raw milk for pasteurization and Grade "A" milk and milk products.⁶ In April of 2001, Vermont adopted the PMO by statute.⁷ A link to the

Got Raw Milk?

The Pasteurized Milk Ordinance prohibits the sale of raw milk. However, Vermont law also exempts anyone selling fewer than 25 quarts of milk per day from the necessity of obtaining a milk handler's license.¹⁶ The VAAFM has taken the position that the milk handler's license exemption takes precedence over the

PMO and has allowed sales of raw milk if sales are less than 25 quarts per day. It should be noted that even within this exemption, farmers are still required to comply with sanitary requirements and are still subject to inspection.¹⁷ The VAAFM, however, has an unwritten policy that if a farm doesn't advertise the availability of raw milk,

the Agency will forgo any inspection.¹⁷

Other states have adopted raw milk sales regulations that impose inspections and sanitary requirements similar to those required for on-farm cheese making. See, for example, http://www.mass.gov/agr/legal/regs/dairy_2700~1_milk_raw_standards.pdf

PMO can be found online through the Vermont Agency of Agriculture, Food and Markets' (VAAFM) website at: <http://www.vermontagriculture.com/PMOexplain.htm>.

The PMO has a number of very specific requirements for milk processing plants, including requirements for the construction of the building itself. The PMO requires that floors be constructed of concrete, tile, brick, or metal surfacing, and that the surface be impervious. The construction material must also be easy to clean.⁸ Walls and ceilings must be smooth, washable, and a light color, so operators can clean them easily.⁹ Any room used to handle, process, or store milk or milk products cannot open directly into a stable or room used for domestic purposes.¹⁰ A

separate room with a toilet is required in each facility. The toilet room cannot open directly into any room where milk is being processed and must have self-closing doors.¹¹ Hand washing facilities are required. They must be easily accessible to both the toilet and the milk plant processing rooms. There must be hot and cold and/or warm running water, soap, and approved hand drying devices. This hand washing facility cannot be the same area as that where bottles and cans are washed.¹² In addition, plans for new milkhouses, milking barns, stables, parlors, milk-tank truck cleaning facilities, milk plants, or receiving and transfer stations – or plans for modification of existing structures – must be approved by the VAAFM.¹³ The

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On-Farm Cheese Processing in Vermont (continued from page 148)

underlying purpose for most of these requirements is to ensure sanitary conditions for handling and processing milk.

In Vermont, a milk handler's license is also required to purchase or process milk.¹⁴ A milk handler is defined as someone who is "engaged in the business of buying, selling, assembling, packaging, or processing milk or other dairy products for sale within or without the state of Vermont."¹⁵ Thus, farmers who are producing cheese on the farm must have a milk handler's license.

You may apply for a new milk handler's license at any time of year, but the license is valid only until September 1 of that year. An initial application costs \$200.00 at this time. To renew a license, you must apply by August 15 of each year. Renewing a license costs \$50.00¹⁸

In order to ensure compliance with the regulations, the VAAFM sends Dairy Product Specialists to conduct unannounced inspections. These specialists inspect both milk plants and dairy farms. A milk plant is "any place, premise, or establishment where milk or dairy products are collected, assembled, handled, processed, stored, pasteurized, packaged, or prepared for distribution."¹⁹ Milk plants must be inspected in order for a milk handler's license to be issued and subsequent to that, must be inspected at least twice a year under Vermont law.²⁰ However, the PMO requires milk plants to be inspected four times a year, and the VAAFM follows this practice. A "dairy farm" is defined

as any place where one or more cows, dairy goats, dairy sheep, or water buffalo are raised and milk from these animals is offered for sale.²¹ Dairy farms must be inspected before they begin to sell milk and, under Vermont statute, must be inspected at least once a year. Again, the VAAFM follows the standard set by the PMO, which is that dairy farms are inspected twice a year. The inspectors look at the premises, equipment, procedures, and sanitation conditions of milk plants as well as dairy farms. In addition, the dairy animals are inspected on dairy farms.²²

If a milk plant is not in compliance with the regulations, the milk handler will be informed of the changes necessary to come into compliance and the time allowed for these changes to occur. If the handler is still not in compliance at the end of this time, the milk handler's license will be suspended or terminated. Similarly, a dairy farm that is found to be in violation of the sanitary regulations will be notified in writing. The farm is given a certain amount of time to come into compliance. At the end of the given time, another inspection is conducted. If the farm is still in violation, the right to sell milk may be suspended or terminated.²³ At the Secretary's discretion, violations can also result in monetary fines of \$25.00 to \$1,000.00 per violation and/or imprisonment for up to one year.²⁴

Inspectors have the right to enter dairy farms and milk plants "at all reasonable times" in order to conduct inspections. Refusal to allow such inspections may result in the revocation of the milk handler's license or

the farm's right to ship milk.²⁵

Wastewater System and Potable Water Supply Permits

To the extent that the PMO requires the construction of a new or modification to an existing wastewater system a wastewater permit may also be required for on-farm cheese processing. These permits are issued by the Agency of Natural Resources (ANR), Department of Environmental Conservation (DEC), Division of Wastewater Management (Division). The ANR is given authority to regulate potable water supplies and wastewater systems under 10 V.S.A. §1978. This same statute authorizes the secretary of the ANR to create rules that regulate potable water supplies and wastewater systems. These rules are called the "Wastewater System and Potable Water Supply Rules" ("Rules") and can be found on ANR's website at: <http://www.anr.state.vt.us/dec/ww/EngServ.htm#wwsapwsr>.

The rules are designed to "establish a comprehensive program to regulate the design, construction, replacement, modification, operation, and maintenance of potable water supplies and wastewater systems in order to protect human health and the environment."²⁶ "Potable water supply" refers to the water itself or equipment used to convey water that is used for drinking, washing, bathing, preparing food, or laundering for human use.²⁷ "Wastewater systems" refers to any system used to convey or treat sanitary

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On-Farm Cheese Processing in Vermont (continued from page 149)

water, including shower water, wash water, and process wastewater.²⁸

The rules apply to soil-based disposal systems with design flows of less than 6500 gallons/day and sewerage connections of any size. A permit is required when a new structure is built or there is change or modification to an existing building or its potable water supply and wastewater disposal system.²⁹ For example, if a farmer wanted to build a new structure for his or her cheesehouse, a wastewater permit would be required. Also, if a farmer took an existing barn and converted all or part of it into a cheesehouse, a permit would be required.

You must submit a number of items with the permit application. Applications must include a plan prepared by a designer.³⁰ A designer is defined as either a professional engineer or someone who holds a designer's license from the ANR.³¹ The type of potable water supply and wastewater system must also be listed.³²

One of the stated purposes of the Rules is to "allow the use of alternative, innovative, and experimental technologies for the treatment and disposal of wastewater."³³ To achieve this end, the ANR does allow a limited number of alternative systems or products. The alternative system or product must conform to the requirements of the Rules, and must be proven reliable. In addition, it cannot place an unreasonable economic or operational burden on the

user.³⁴ Experimental designs are also permitted if they meet the same requirements as alternative systems. In addition, they must be based on scientific and engineering principles.³⁵ Applications for alternative systems and experimental designs are available from the ANR. All alternative technology applications must be approved by the ANR.

The wastewater permit exempts a number of situations. A cheesehouse may be exempt from the wastewater permit requirement if the building itself and its potable water supply and wastewater system existed before June 1, 1970, and have not been modified since that time.³⁶ Secondly, it may also be exempt if it is on the same lot as a single family residence and uses the same potable water supply and wastewater system as the residence. In this case, the cheese making operation must be run by someone who lives in the residence, and the public cannot regularly visit the facility. A third exemption permits regular visits by the public and nonresident employees, as long as there is no increase in design flow of the water supply or wastewater system. The farmers are required to test the water for bacteria, lead, nitrate, sodium, and arsenic, as well as show compliance with drinking water standards established by the ANR. Fourth, a cheesehouse may be exempt if a water supply and wastewater permit was issued prior to August 16, 2002, even if the public and nonresident employees visit it. Lastly, if an existing potable water supply or wastewater system requires only a minor

repair, it may be exempt.³⁷ Any exemption status should be confirmed by a Regional Engineer at a DEC Regional Office.³⁸

Unlike the milk handler's license, the wastewater permit has a one-time only fee. The wastewater permit "runs with the land." It is recorded in the land records of the municipality where the land is located and is applicable to the land itself, even if a new owner purchases the property at a later date.³⁹ The fee for the original permit application is a minimum of \$210.00. You can find a copy of the fee chart on the ANR's website at: <http://www.anr.state.vt.us/dec/ww/EngServ.htm>.

A permit or amendment may be required in the future if there is additional construction, change to the water supply or wastewater disposal system, an increase in the design flow of either the water supply or wastewater discharge, etc. The Regional Engineer at a Regional Environmental Office should be contacted, as he/she will determine whether the proposed changes affect the permitting status of the operation.

The permittee may petition for revocation of the wastewater permit. The ANR may also revoke permits for one of the following causes: violation of permit conditions, providing false information on the application, incorrect design installation, and/or violation of the Rules.⁴⁰ These actions can also lead to fines and/or court action.⁴¹

continued on page 151



REGULATION OF ON-FARM FOOD PROCESSING AND MARKETING

On-Farm Cheese Processing in Vermont (continued from page 150)

Indirect Discharge Permits for Food Processing Wastes

On August 14, 1990, the ANR issued Vermont Guidelines for Land Application of Dairy Processing Wastes (“guidelines”). The premise of the guidelines is that dairy processing wastes, meaning whey and washwaters, should be considered a resource instead of waste, and that application of whey and washwaters to fields is beneficial because these materials add nutrients to the land.⁴² The guidelines explain why whey and washwaters are beneficial to soil and establish an environmentally sound procedure for land application. The guidelines were written with large dairy operations in mind. As a consequence, some information in this section may not be relevant to small cheese making operations. Nonetheless, the guidelines are used in the issuance of indirect discharge permits for all cheese production facilities.

Whey and washwaters can be applied to the land either directly by spraying them on the field or indirectly by adding them to a manure pit where they are mixed and eventually sprayed onto the field. If added to a

manure pit, whey and washwaters may constitute up to 10 percent of the total volume in the pit per year. If a cheese maker uses milk only from his or her cows, processes the cheese on the farm, and also disposes of the waste on the farm, no permit is required. However, if any of the milk used to make cheese comes from off the farm or if any of the waste is disposed of off the farm, an indirect discharge permit is required because these activities change the definition from a “cheese-making operation” into a “cheese production facility.”

The Indirect Discharge Permit Section (“section”) of the Wastewater Management Division issues indirect discharge permits. The secretary – or his or her representative – is authorized to issue these permits under 10 V.S.A. §§1251(a), 1259(e) and 1263. The permits are generally valid for five years; however, a shorter period is possible at the secretary’s discretion. Three fees are associated with this permit. The first is an application review fee of \$.06/gallon of design capacity, or a minimum of \$235.00. This fee is due only with the initial permit application. The second fee

is an administrative processing fee of \$100.00 for new permits, amendments, and renewals. Last, there is an annual operating fee of \$.013/gallon of design capacity, or a minimum of \$100.00. A copy of the fee schedule is available at: <http://www.anr.state.vt.us/dec/ww/Indirect.htm>.

Indirect discharge permits may be revoked or suspended by the secretary if the permittee violates the conditions of the permit or submits false information with the application.⁴³ However, the permittee must first be notified by mail of the noncompliance and the steps required to fix the problem. If the permit holder still does not comply, a second notice is sent. After this, it is within the secretary’s discretion to bring suit in the superior court in the county where the noncompliance has occurred.⁴⁴ The court may enjoin the discharge, award punitive damages and civil penalties, and order the removal of the waste.⁴⁵ However, it is rare that proceedings get further than sending a second letter because most permittees choose voluntary compliance.



REGULATION OF ON-FARM FOOD PROCESSING AND MARKETING

Product Licensing and Exemptions

Product/ Commodity	Primary Responsible Agency	License/ Inspection Needed	Home Processing Allowed	Sales/Volume Exemption	Notes
Baked Goods	VT Dept. of Health	Yes/yes	Yes	\$125 per week before licensing	
Dairy	VT Agency of Agriculture	No/Yes	No	25 gal/day raw milk can be sold off farm	
Fresh Juice	VT Dept. of Health	Yes/yes	No	\$10,000 sales/ year before license	HACCP required
Honey	VT Agency of Agriculture	No/Yes*	Yes	Under 10 hives exempt from registration	*Registration required
Maple	VT Agency of Agriculture	Yes/Yes	Under 2500 gallons	Below 2500 gallons/year exempt from licensing	
Meat/Poultry Processing	VT Agency of Agriculture/USDA	Yes/Yes	No	Various exemptions for small-scale poultry slaughter	
Raw Fruit/Vegetable Processing	VT Dept. of Health	No/No	Yes	n/a	
Specialty Foods	VT Dept. of Health	Yes/Yes	Yes*	Under \$10,000 sales/year not licensed	*Not for wholesale trade



REGULATION OF ON-FARM FOOD PROCESSING AND MARKETING

Vermont State Agency Contact Information as of March 2006

Agency	Name	Phone/e-mail	Notes
Vermont Department of Health, Food, and Lodging Program	Al Burns, Supervisor	802-863-7221	Can also provide guidance on FDA regulations
Vermont Agency of Agriculture, Meat Inspection Program	Carl Cushing	802-828-2426 carl@agr.state.vt.us	Can also provide information and contact on USDA inspection
Vermont Agency of Agriculture, Dairy Section	Byron Moyer, Section Chief	802-828-2433	
Vermont Agency of Agriculture, Consumer Protection Section, maple products, weights, measures and labeling	Henry Marckres, Supervisor	802-828-3458	

Sample Lease Agreement

Preamble and Statement of Purpose

THIS AGREEMENT ("Agreement") is made this ____ day of ____, 200__, effective as of ____, ____, 200__, between [Landowner], with a business address of _____ and [Farmer], with a business address of _____, to lease certain parcels of agricultural land for the purpose of farming activity as described more fully in this lease.

NOW, THEREFORE for good and valuable consideration stated herein, the sufficiency of which is hereby acknowledged, the parties agree as follows:

I. Agreement to Lease.

[Landowner] agrees to lease to [Farmer], and [Farmer] agrees to rent from [Landowner] the Premises (as defined in Section 2) on the terms and conditions stated in this Agreement and the attached Exhibits.

II. Description of Premises.

Certain real and personal property in [Town, State] commonly known as _____, consisting of the following:

III. Lease Term, Renewal, and Termination.

The term of this lease shall run for a period of ____ years beginning on ____, 200__, and ending on ____, 200__.

Optional Renewal provision:

The parties shall have the option of renewing the lease for an additional ____-year period. Renewal shall occur only upon [Farmer's] delivery to [Landowner] by ____, 200__ of a written request to renew the lease for the additional period. Upon said delivery, Landlord shall have until ____, 200__ to provide written notice of its acceptance or rejection of [Farmer's] renewal offer. If [Farmer] fails to deliver such renewal notice, the lease shall terminate at the end of the initial term; conversely, if [Landowner] fails to notify [Farmer] in writing of its decision, the lease shall automatically renew for the additional ____-year period.

IV. Permitted Uses.

A. [Landowner] permits, authorizes, and consents to [Farmer's] undertaking all activities incident to agricultural uses of the Premises, including:

- (i) _____
- (ii) _____
- (iii) _____
- (iv) _____

B. [Farmer] agrees to comply with [State's] "Accepted Agricultural Practices," which are incorporated herein by reference. [Farmer] and [Landowner] shall work cooperatively with the Natural Resources Conservation Service to develop a conservation plan for the farm. [Farmer] agrees to adopt all best management practices recommended by NRCS within a reasonable time frame identified in the conservation plan. The conservation plan shall be periodically reviewed by [Landowner] and [Farmer] to ensure compliance.

C. [Farmer] agrees to comply with all federal, state, and local laws, regulations, ordinances, decrees, and rulings in connection with the use of the premises and any agricultural or other activities conducted thereon, including but not limited to any and all regulations, directives, and procedures necessary to ensure that [Landowner] continues to qualify for Current Use status under the State's tax code.

D. [Farmer] may use the Farmhouse as a primary residence so long as this lease is in force. The rental of the dwelling shall be governed by a separate residential lease and both [Farmer] and [Landowner] agree that state law regarding residential rental agreements shall govern. Use of the residence is subject to the following conditions: [to be completed by parties]

- (i) _____
- (ii) _____
- (iii) _____
- (iv) _____

V. Prohibited Uses.

A. [Farmer] shall not, without the prior written consent of [Landowner] engage in any of the following activities on said parcels: [to be completed by parties]

- (i) _____
- (ii) _____
- (iii) _____
- (iv) _____

B. Consent to engage in prohibited uses, or to engage in uses not clearly permitted shall be obtained by submitting a written description of the proposed use including the location and scope of the proposed use. [Landowner] may approve, disapprove, require more information, or require certain modifications to the proposed improvement. [Farmer's] final written proposal including a clear indication of [Landowner's] assent and signed by [Landowner] shall constitute written consent of [Landowner].

VI. Rent and Taxes.

A. [Farmer] shall pay to [Landowner] without demand, rent in the amount of _____ per month (the "Rent"). [Farmer] shall deliver the rent by the first day of each month at the address specified in the Preamble. A late penalty of ___[e.g., 5%] per month will be assessed on all late payments. [Farmer] agrees and acknowledges that the late penalty is necessary to compensate [Landowner] for lost interest, the opportunity cost of renting the property, and any legal fees or expenses incurred in enforcing its rights pursuant to this Agreement.

B. Prior to taking possession of the property, [Farmer] shall deliver to [Landowner] a security deposit of \$_____.

Alternative Provisions

Crop share:

A. All costs and returns shall be divided between [Landowner] and [Farmer] as provided below.

(a) The [Farmer] shall pay as rent the shares or quantities of crops as indicated below:

Crop	Acres	Share paid as rent	Place of Sale or Delivery
1.	_____/_____/_____	/_____	/_____
2.	_____/_____/_____	/_____	/_____
3.	_____/_____/_____	/_____	/_____
4.	_____/_____/_____	/_____	/_____

(b) [Farmer] shall consult with [Landowner] regarding the time, price, and other manner of sale of crops prior to any sale.

(c) [Landowner] shall pay the following share or quantities of expenses as indicated below:

Expense	Share or Amount Paid to [Farmer]	Date of Payment
1. _____	_____/_____/_____	
2. _____	_____/_____/_____	
3. _____	_____/_____/_____	
4. _____	_____/_____/_____	

(d) [Farmer] shall consult with [Landowner] regarding any shared expenditure which exceeds \$_____.

C. [Landowner] shall pay for all taxes and assessments on the Premises, with the exception of those taxes that are directly attributable to agricultural or other production- and sales-based activities being conducted by [Farmer] on the Premises.

D. If [Landowner] accepts an offer for a renewal term, the annual rent for the renewal term shall be adjusted using the CPI for the New England region in [year of renewal] as an index and the [first year of lease] as a base year (as set forth by the Government of the United States, Base Year = 1982-1984). The rent shall not decrease during the renewal term.

VII. Utilities

[Farmer] agrees to pay in a timely manner any and all utilities for use of the Premises, including, without limitation, electricity, fuel oil, gas services, telephone, trash collection, snow plowing, lawn mowing, water, sewer service, cable or satellite television reception, internet connection fees, and any other such services associated with the [Farmer's] use of the Premises and the Farmhouse.

VIII. Repairs, Maintenance, and Replacement

A. [Landowner] shall be responsible for major rehabilitation, repair, or replacement of the structural components and operating systems upon the premises which are pre-existing assets of [Landowner] and which are not short-term or cyclical consumables. [Landowner] shall not be responsible for minor or routine repairs or replacements. [Landowner's] responsibilities shall be understood to include, but are not limited to, the following:

- (a) Structural component – Repair/replacement of all structural systems – foundations, floors, walls, and roof systems.
- (b) Exterior fabric – General replacement of siding, trim, porches, and steps.
- (c) Roofing – General replacement of shingles, flashing, gutters, downspouts.
- (d) Water supply systems (household) – Replacement or major repair to wells or cisterns, replacement of non-repairable pumps.
- (e) Waste treatment – Replacement or major repairs to toilets, holding tanks, leach fields.
- (f) Heating, ventilating, and air conditioning – Replacement of major system components.

B. [Farmer] shall be responsible for all general maintenance and minor repairs of the buildings and their operating systems. Should [Farmer] and [Farmer's] agents or repair persons determine that a component or system is no longer able to be repaired and should [Landowner] concur in that judgment, [Landowner] will fulfill its responsibility to replace such a component or system. Short of the need for such replacement, [Farmer's] repair and maintenance responsibilities include, but are not limited to:

- (a) Structural components – Diligent prevention or removal of any and all deteriorating conditions or factors.
- (b) Exterior fabric – Minor or localized repairs, such as window glazing, glass replacement, or periodic repainting/staining.
- (c) Roofing – Localized minor repairs/replacement of shingles, flashing, or gutters.
- (d) Water systems (household) – All servicing and repair of pumps, water lines, fixtures, and the repair of water tanks and water heaters.
- (e) Waste treatment – Unblocking/repair of toilets or sewage lines, cyclical and emergency septic pumping.
- (f) Heating, ventilating, air conditioning – All filters, servicing, adjustments or repair.

C. Residential Grounds Maintenance – [Farmer] shall be responsible for maintaining residential grounds in an aesthetically pleasing manner at [Farmer's] sole expense. Aesthetically pleasing is understood to include, but is not limited to, regularly mowed and managed lawns and ornamental plantings and avoidance or removal of unsightly storage or parking of materials, equipment, and vehicles. [Farmer] is responsible for all aesthetic/utilitarian snow removal.

D. On or before January 31 of each year, [Landowner] and [Farmer] shall complete and sign a “repairs, maintenance, and replacement worksheet” indicating the repair and replacement work to be completed for that year; the estimated cost of each project; the share of the cost to be contributed by each; any labor to be contributed to the work by [Farmer]; and the date by which the work is to be completed. The total cost for repairs and maintenance, including the value of [Farmer’s] labor in any given year, shall not exceed _____. The total cost of replacements in any given year shall not exceed_____.

IX. Improvements

A. [Farmer] shall not make alterations or improvements to the Premises without the written consent of [Landowner]. Consent shall be obtained by submitting a written description to [Landowner] of the proposed improvement, including its location, size, proposed use, and whether the improvement is to be severed from the property at the termination of the lease or is to be left on the property, and any other information that may be required by the landowner. [Landowner] may approve, disapprove, require more information, or require certain modifications to the proposed improvement. [Farmer’s] final written proposal including a clear indication of [Landowner’s] assent and signed by [Landowner] shall constitute written consent of [Landowner]. [Unless otherwise agreed by both parties, approved improvements shall be at the sole expense of [Farmer].

B. Maintenance and repair of [Farmer’s] improvements – [Farmer] shall be responsible for all major and minor maintenance, repairs, or replacement of any and all alterations or improvements to the premises made under paragraph 9.1.

C. Improvements made under paragraph 9.2 that are capable of severance may be removed by [Farmer] at any time or within 30 days after termination of the lease even though they may be fixtures, provided that [Farmer] leaves in good condition that part of the farm from which such improvements are removed.

D. Improvements not capable of severance shall become the property of [Landowner] at termination of the lease without compensation to the farmer

Alternative to D: [Landowner] shall pay [Farmer] the depreciated value of any non-removable improvements at the termination of this lease, provided the initial cost of such improvement exceeds _____. Depreciation will be determined on the basis of the useful life of the improvement.

X. Successors and Assigns

This Agreement is binding on all persons who may succeed to the rights of [Landowner] including but not limited to heirs, executors, assigns, and purchasers, as applicable, and in accordance with this Agreement.

[Farmer] may not assign this Lease Agreement and the lease interest in the Premises represented herein, sublet all or any part of the Premises, or allow any person to occupy the Premises for an extended period without, in each instance, [Landowner’s] express written permission.

XI. No Partnership Created

This lease shall not be deemed to give rise to a partnership relationship and neither party shall have authority to obligate the other without written consent, except as specifically provided in this lease.

XII. Insurance

A. [Farmer] will maintain general liability insurance policy with coverage of _____ and naming [Landowner] as an additional insured during the period of the lease. [Landowner] will maintain fire and extended casualty insurance coverage on the Premises in a sum of not less than _____. Evidence of insurance shall be provided to the other party.

B. [Landowner] agrees to maintain fire and extended insurance coverage adequate to replace or repair the dwelling or any other farm building or equipment regularly used by [Farmer] that may be destroyed by fire, flood, or other casualty loss and to replace or repair such structures in the event of loss as soon as practicable.

XIII. Default

A. The following events shall constitute default under this Agreement (for example): [to be completed by parties]

- (i) _____
- (ii) _____
- (iii) _____
- (iv) _____

B. A default under any of the provisions of this Agreement by either party may be cured by the defaulting party within 30 days of receipt of a notice of default. Failure to cure shall constitute grounds for termination of the lease or withholding of rent at the election of the non-defaulting party.

C. In the event the Lease is terminated due to the default of [Farmer]:

- (i) All obligations of [Landowner] under this Agreement shall cease. [Landowner] shall take reasonable measures to lease the Premises to another tenant for a comparable term and rent.
- (ii) Until [Landowner] enters into a new lease [Farmer] shall continue to pay the applicable rent until the end of the Lease Term. [Landowner] may retain a portion of the security deposit to cover his costs of re-letting the premises.
- (iii) Rental payments received by [Landowner] from a new tenant will reduce the amount for which [Farmer] is liable to [Landowner].
- (iv) Upon termination, [Farmer] agrees to yield possession of the premises within 90 days of the date of notice of default, reserving the right to re-enter the premises solely to harvest any crops that are the personal property of [Farmer] and are growing at the time of default.

D. In the event the Lease is terminated due to the default of [Landowner].

- (i) All obligations undertaken by [Farmer] under this Agreement including the obligation to pay rent shall cease.
- (ii) Upon termination, [Farmer] shall yield possession of the premises in a timely manner, reserving the right to re-enter the premises solely to harvest any crops that are the personal property of [Farmer] and are growing at the time of default. [Landowner] shall remit an amount equal to two times the [Farmer's] security deposit as liquidated damages and here agrees that such an amount is a reasonable approximation of the costs incident to moving a farming operation.

XIV. Dispute Resolution

A. Prior to taking any action in a court of law, the parties to this agreement agree to endeavor in good faith to appoint a dispute resolution committee to evaluate the dispute and make recommendations for its resolution. The Dispute Resolution Committee shall consist of the following three persons: (1) One adult person appointed by [Farmer] who is not a member, partner, director, or employee of [Farmer] nor an immediate family member; (2) One adult person appointed by [Landowner] who is not a director, officer, employee, or shareholder of [Landowner] or its directors; and (3) a neutral individual with expertise in farm-related matters, to be agreed upon by both parties after a good faith evaluation. The Dispute Resolution Committee shall, within 90 days of its formation and after reviewing written submissions and any supporting evidence submitted by both parties, make findings of fact and suggestions for resolving the dispute to be delivered to the parties in writing. The parties may accept the resolution recommended by the committee or propose an alternative resolution. The parties, however, hereto agree and acknowledge that the Dispute Resolution Committee's findings of fact shall be presumptively valid with the burden resting on the complainant in any legal proceeding to demonstrate otherwise. [Farmer] and [Landowner] each agree to assume 50% of the costs of the Evaluation Committee in the event such Dispute Resolution Committee is resorted to.

XV. Right of Entry

[Landowner] may enter the Premises at reasonable times in order to examine the Premises, inspect repairs or alterations, and replace mechanical or other systems. [Landowner] will give [Farmer] 48 hours prior notice of such entry. In the event of an actual or apparent emergency, [Landowner] may enter the Premises at any time without notice. [Farmer] will not change any lock or install additional locks without [Landowner's] prior written consent and without providing [Landowner] a copy of all keys. Keys must be provided on the date the lock(s) are added or/and changed.

XVI. Severability

If any part of this Agreement is invalid or unenforceable, the balance of this Agreement shall remain effective, absent such provision.

Memorandum of Lease

(To be filed in the town land records)

KNOW ALL PERSONS BY THESE PRESENTS that Landowner and Lessee identified below are parties to a certain lease agreement dated _____, 200__ containing the following terms and conditions:

Lessor:

Lessor address:

Lessee:

Lessee address:

Leased property:

Date of execution: _____, 20__.

Lease term:

Commencement date:

Expiration/termination:

Rights to extend or renew:

Rights to purchase:

Right of first refusal:

Assignment and Sublease:

This memorandum of lease will be recorded in the town of [Town] to provide notice of the lease pursuant to 27 V.S. A. § 341(c). The lease contains terms and conditions in addition to those set out here. This Memorandum of Lease is not intended to amend or modify the terms and conditions of the lease. To the extent that the terms and conditions of this Memorandum of Lease differ from the terms and conditions of the lease, the terms and conditions of the Lease shall govern and prevail.



A LEGAL GUIDE TO THE BUSINESS OF FARMING IN VERMONT

References

Chapter I: Legal Structure of the Farm Business

1. 2002 Agriculture Census, Table 40 Number of Operators, Type of Organization, and Principal Operator Characteristics, 2002 and 1997.
2. Vermont Secretary of State Website: <http://www.sec.state.vt.us/tutor/dobiz/numbers.htm>.
3. See for example, *Agway, Inc. v. Brooks*, 172 VT 407 (2000).
4. 11 V.S.A. §3005(a) for LLC, 11 V.S.A. §11A V.S.A. §4.01 for corporations.
5. 11 V.S.A. §3056(a)(1) and (2).
6. 11 V.S.A. § 1621.
7. 11 V.S.A. §3201(6).
8. 11 V.S.A. §3201(10).
9. 11 V.S.A §3212.
10. 11 V.S.A. §3212(c).
11. 11 V.S.A. §3221.
12. 11 V.S.A. §3223.
13. 11 V.S.A. §3234.
14. 11 V.S.A. §3226.
15. 11 V.S.A. §3226(c).
16. 11 V.S.A. §3291, et seq.
17. See IRC §704(d), IRC §465 and IRC §469.
18. I.R.C. §721(a).
19. See Kelly, Christopher. Introduction to Federal Farm Program Payment Limitation and Payment Eligibility Law. National Agricultural Law Center, University of Arkansas School of Law, June 2002 at 15.
20. See also, 7 C.F.R. §1400.3.
21. See 7 C.F.R. §1400.105(a).
22. See 7 C.F.R. §1400.201.
23. 11 V.S.A. § 3043.
24. I.R.C. § 465 and 469; I.R.C. § 704(d).
25. 9 V.S.A. §4201a((16).
26. In re Gorman 82 B.R. 253 (D.Vt. 1987) and In re Russell, 80 B.R. 662 (Bkrcty.D. Vt. 1987).
27. 32 V.S.A. § 3752(11).
28. 32 V.S.A. § 9602(2).
29. 32 V.S.A. § 9603(11).
30. 32 V.S.A. § 10005(c).
31. Until a certificate is issued anyone acting on behalf of the corporation, knowing that a corporation has not yet been formed will be personally liable for debts or acts committed.
32. 11A V.S.A. §8.30.
33. 11A V.S.A. §6.22.
34. 11A V.S.A. §6.40(c).
35. 11A V.S.A. §20.01 through 20.16.
36. For more on the notion of “Agriculture as a Public Good” see contribution of George Boody in *The Farm as Natural Habitat*, pp. 261-275. 2002 Island Press.
37. 11B V.S.A. §8.02.
38. 11B V.S.A. §8.13(b)(1).
39. 32 V.S.A. §5811(3).
40. 32 V.S.A. §9202(3).
41. 32 V.S.A. §9743.
42. 32 V.S.A. §10002(j).
43. 32 V.S.A. 3802(4).
44. There is a three part test for determining this exemption. For an application of the test in the context of a research farm see, *Sigler Foundation v. Town of Norwich* 174 Vt. 129(2002).
45. 26 U.S.C §511, et seq.
46. 11B V.S.A. §3.02(14).
47. 11B V.S.A. §3.01(a).
48. 11B V.S.A. §6.22.
49. 7 U.S.C. §291.
50. 11 V.S.A §1030.
51. 11 V.S.A. §981.
52. Also includes landowners who receive produce under a crop share lease. 11 V.S.A. §998, 11 V.S.A. §991(8).
53. 11 V.S.A. §1023.
54. 11 V.S.A. §994(1).
55. 11 V.S. A. §1016.
56. 11 V.S.A. §1031.
57. 9 VSA § 4204a(a)(10).

Additional Resources Consulted for this Chapter:

Friedland, Jerold A., *Understanding Partnership and LLC Taxation*, 2nd Edition. Matthew Bender and Co./LexisNexis Group. 2003

Cartano, David J. *Federal and State Taxation of Limited Liability Companies*. Aspen Publications.



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Frederick, Donald A. *Co-ops 101: An Introduction to Cooperatives*, USDA, Rural Business Cooperative Service. 1997 edition.

Coltrain, David, David Barton, and Michael Boland. *Differences Between New Generation Cooperatives and Traditional Cooperatives*. Arthur Capper Cooperative Center, Department of Agricultural Economics, Cooperative Extension Service, Kansas State University. 1999.

Kelly, Christopher. *New Generation Farmer Cooperatives*. 4 *Agricultural Law Update* May 2000.

Waner, Jennifer. *New Generation Cooperatives: Case Study*. *New Generation Cooperatives and the Future of Agriculture: An Introduction*. Illinois Institute for Rural Affairs.

Chapter II: Farm Transfer and Estate Planning

1. See Sharon Danes, Associate Professor, Family Social Science Department, University of Minnesota, *Transferring the Farm Series*, University of Minnesota Extension Service.
2. *Tucker v. Colburn* 140 Vt. 186 (1981).
3. 26 U.S.C. §121.
4. 14 V.S.A. §551.
5. 14 V.S.A. §683.
6. 15 V.S.A. §67.

7. 27 V.S.A. §2(a).
8. 27 V.S.A. §2(b)(1).
9. 32 V.S.A. §9603(5).
10. See Vermont Department of Taxes, Ruling 94-10 (November 7, 1994).
11. 27 V.S.A. §101.
12. See McEowen and Harl, *Proposed Repeal of the Federal Estate Tax – Is this a good idea for agriculture?* *Agricultural Law Update* 4, January 2005.
13. McEowen and Harl, and IRS Statistics of Income Division, November 2004, accessible at <http://www.irs.gov/pub/irs-soi/03es05gr.xls>.
14. See McEowen and Harl.
15. See McEowen and Harl.
16. 26 U.S.C. § 2032A (2005).
17. 26 U.S.C. §2032A(b)(1)(A)-(C).
18. 26 U.S.C. §2032A(c)(8).
19. Rev. Rul. 2004-63.
20. See *Strangi v. Comm’r* 115 T.C. 478 (2000) and IRC Section 2036(a)(1) *Strangi V Comm’r TC Memo* 2003-145.
21. See, for example, *Stone v. Comm’r TC Memo* 2003-309.
22. Under IRC Section 2036(a)(2).
23. See 26 U.S.C.S. §2031(c) and Lindstrom, Timothy, *Tax Notes - - The Tax Benefits of Conservation Easements*. 79 *MI Bar Jnl.* 690 (2000).
24. 26 U.S.C.S. §6166 (2005).
25. 26 U.S.C.S. §6166(b)(3) (2005).
26. 26 U.S.C.S. §6166(g) (2005).
27. 32 V.S.A. §7443.
28. The rules are available from the Vermont

Agency of Human Services, Economic Services Division at 802-241-2937.

29. DCF rules M432.31.

30. DCF rules M232.11 Proceeds from the sale of a principal residence are also excluded, provided they are reinvested in a primary residence within three months of the sale. And proceeds from a reverse mortgage are also excluded “in the month of receipt” meaning it must be spent in that month.

31. This is a federal rule. See, 42 U.S.C. §1396p(d)(3) and §1396p(e).

32. Section 6014, Deficit Reduction Act of 2005 amending 42 U.S.C. §1396p.

33. DCF rules M232.15.

34. Section 6011, Deficit Reduction Act of 2005 amending 42 U.S.C. §1396p(c)(1)(B)(i).

35. DCF rules M233.23.

36. DCF rules M233.1.

37. DCF rules M230.

38. DCF rules M232.81.

39. DCF rules M232.16.

40. Section 6016 Deficit Reduction Act of 2005, amending 42 U.S.C. §1396p.

41. DCF rules M232.17.

42. DCF rules M232.2.

43. DCF rules M232.84.

44. DCF rules M232.98.

45. DCF rules M440.3(g).

46. Section 6011, Deficit Reduction Act of 2005 amending 42 U.S.C. §1396p.

47. DCF rules M440.3(d).

48. DCF rules M440.3(d).



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49. McEowen, Roger. New Medicaid Rules Will Impact Estate Planning for Long Term Health Care. 17 Agricultural Law Digest, no. 7, March 31, 2006.
50. DCF rules M440.31(a).
51. See 42 U.S.C. §1396p (d)(3) and §1396p(e).
52. DCF rules M440.31(b).
53. DCF rules M440.4.
54. DCF rules M440.42.
55. She would have to file a gift tax return because the gift is in excess of the \$11,000 annual gift exclusion.
56. DCF rules M440.44(a).
57. Section 6011, Deficit Reduction Act, amending 42 U.S.C. § 1396p(c)(2)(d).
58. DCF rules M159.1.
59. DCF rules M159.21.
60. DCF rules M159.2(b)(1).
61. DCF rules M159.2(b)(1).

Chapter III: Farmland Tenure and Leasing

1. This section draws heavily on Holding Ground: A Guide to Northeast Farmland Tenure and Stewardship, published by the New England Small Farm Institute and available at the NESFI Bookstore at <http://www.smallfarm.org/bookstore/#nesfi>.
2. USDA, NASS, 2002 Census of Agriculture – State Data, Table 40.
3. USDA NASS 2002 Census of Agriculture, Tenure, Number of Operators, State Data, Table 40 and 1999 Agricultural Economics and Land-

- ownership Survey, Table 99.
4. 32 V.S.A. §3752(1), (7) and (14) (2005).
5. Professional Development for the Adoption of Sustainable Agriculture on Rented Land, Final Research Report. Michael M. Bell, Michael S. Carolan, Department of Sociology, College of Agriculture, Iowa State University. Ames, Iowa. Nov. 19, 2002.
6. 1988 AELOS, Table 3, 1999 AELOS Table 3.
7. USDA, NASS 1999 Agricultural Economics and Landownership Survey, Tables 35, 68 and 69 and 79 and 99 and 103; available at: <http://www.nass.usda.gov/census/census97/aelos/aelos.htm>. 1988 Agricultural Economics and Landownership Survey, Table 67, available at: <http://www.nass.usda.gov/census/aelos88/aelos88.htm>.
8. As You Sow: Three Studies in the Social Consequences of Agribusiness. Walter Rochs Goldschmidt, 1978.
9. 32 V.S.A. §3752 et Seq.
10. 32 V.S.A. §9602(2).
11. 32 V.S.A. §3757(g)(1).
12. 12 V.S.A. § 181 (5) (Supp.).
13. *Chomicky V. Buttolph*, 147 Vt. 128 (1986).
14. 27 V.S.A. § 341(a)-(c).
15. Self employment tax is paid at a rate of 15.3% on income up to \$84,900 (2002). Farmers fought for this treatment to increase their self-employment earnings and thereby increase their social security benefits.
16. 9 V.S.A. §4457.
17. Adapted from Countryside Initiative Lease.

18. 32 V.S.A. §3752(12) and (14).
19. Philip Harris, Zoel Daughtrey, Agricultural Tax Issues and Form Preparation, Agricultural Tax Issues School, June 5-6, 2001 page 95.
20. Professional Development for the Adoption of Sustainable Agriculture on Rented Land. Final Research Report. Michael M. Bell, Michael S. Carolan, Department of Sociology, College of Agriculture, Iowa State University. Ames, Iowa. Nov. 19, 2002.
21. Bell, *ibid*.
22. Bell, p. 3.
23. <http://www.nps.gov/cuva/management/countryside/>.
24. *Turgeon v. Schneider*, 150 Vt. 268 (1988); *Prevo v. Evarts*, 146 Vt. 216 (1985); *Blood v. Spaulding*, 57 Vt. 422 (1884).
25. *Johnstone v. Bushnell*, 118 Vt. 162, 164, 102 A.2d 334, 336 (1954).
26. *Morgan v. Renehan-Akers Co.*, 126 Vt. 494, 496, 236 A.2d 645, 647 (1967) and *Seewaldt v. Mount Snow, Ltd.*, 150 Vt. 238, 241, 552 A.2d 1201, 1202 (1988).
27. *Lomberg v. Renner*, 121 Vt. 311, 315, 157 A.2d 222 (1960).
28. *Buzzell v. Jones*, 151 Vt. 4, 6, 556 A.2d 106, 108 (1989); *Hillierv. Noble*, 142 Vt. 552, 556, 458 A.2d 1101, 1103 (1983).
29. 12 V.S.A. §5791 et seq.
30. 12 V.S. A. §§4911 through 4920.
31. 12 V.S.A. §§4851, 4773, 4852, 4853a, and 4854.
32. 27 V.S.A. §341(a).



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33. 27 V.S.A. §341(c)(1)-(9).
34. 27 V.S.A. §342.

Chapter IV: Agriculture and Land Use Regulation

1. *Coty v. Ramsay Assoc., Inc.*, 149 Vt. 451(1988).
2. See Restatement (Second) of Torts §826 and *Untangling the Nuisance Knot*, 26 B.C. Envtl. Aff. L. Rev. 89 (Fall 1998).
3. *Coty v. Ramsay Assoc., Inc.*, 149 Vt. 451 (1988).
4. *Trickett v. Ochs*, 838 A.2d 66 (Vt. 2003).
5. 12 V.S.A. § 5751 et seq.
6. *Borman v. Board of Supervisors*, 584 N.W.2d 309 (Iowa 1998).
7. *Legal Issues Related to the Use and Ownership of Genetically Modified Organisms*, 43 *Washburn Law Journal*, July 2004.
8. 6 V.S.A. § 644.
9. 6 V.S.A. § 644 (a)(4).
10. 6 V.S.A. § 648(g).
11. 6 V.S.A. § 641(9) and (10).
12. *Swanson v. Bishop Farm, Inc.*, 140 Vt. 606, 610 (1982)
13. 24 V.S.A. §4413(d)
14. 24 V.S.A. § 4414(1)(B).
15. *Community Rules: A New England Guide to Smart Growth Strategies*, Conservation Law Foundation and Vermont Forum on Sprawl, Chap. 4, (2002).
16. 24 V.S.A. §4413(d)(1)-(2).

17. 24 V.S.A. §4413(d)(1).
18. 24 V.S.A. §4495(a).
19. 10 V.S.A. §6086.
20. 10 V.S.A. §6001(22).
21. RE: *Scott Farm, Inc. DR #413 1/16/2003*.
22. In re: *Southwestern Vermont Health Care Corp.*, #8B0537-EB (2/22/01).

Chapter V: Farm Labor Regulation

1. 29 U.S.C. §§ 201-219.
2. 21 V.S.A. §§301-453.
3. 21 V.S.A. §384.
4. 29 CFR §780.114.
5. 21 V.S.A. § 383(2)(A).
6. 29 CFR §780.305(a).
7. *Reich v. Parker Fire Protection Dist.* 992 F.2d 1023 (10th Cir. 1993).
8. 29 C.F.R. §780.332.
9. *Walling v. Portland Terminal Co.*, 330 U.S. 148, 152 (1947).
10. Find them at: http://www.state.vt.us/labind/Wagehour/adopted_child_labor03.pdf.
11. Vermont Child Labor Rules, Effective October 6, 2003 Part G, page 38.
12. FLSA §16(a).
13. The Agricultural Job Opportunities, Benefits and Security Act or the “Ag Jobs” co-sponsored by Senator Leahy is one example.
14. See 20 C.F.R. §655.90 – 655.113.
15. 29 U.S.C. §1802(8)(B)(ii).
16. Lowell, Suro. The Pew Hispanic Center. *How Many Undocumented: The Numbers Behind the*

- U.S. Mexico Migration Talks* (2002).
17. The National Agricultural Workers Survey is available at: <http://www.doleta.gov/agworker/report9/toc.cfm>.
 18. *Robertson V. Mylan Laboratories, Inc.* 176 Vt. 356, 848 A.2d 310 (2004).
 19. *Hodgdon v. Mt Mansfeild Company, Inc.* 160 Vt. 150, 624 A.2d 1122(1992).
 20. 21 V.S.A. § 495(a)(2).
 21. 42 U.S.C. § 12101 et seq.
 22. 21 V.S.A. § 495d(1).
 23. 21 V.S.A. § 495d(5)(C).
 24. 21 V.S.A. §495d(12).
 25. 21 V.S.A. §495(a)(8).
 26. In re *Butler*, 166 Vt. 423 (1997).
 27. 21 V.S.A. §495b(a) – (c).
 28. OSHA §5(a)(1).
 29. 29 C.R.R. §1928.110.
 30. 29 C.F.R. §1928.51.
 31. 29 C.F.R. §1910.145(d)(10).
 32. 29 C.F.R. §1928.57.
 33. 29 C.F.R. §1910.111.
 34. 29 C.F.R. §1910.266.
 35. 21 V.S.A. §471(1).
 36. 21 V.S.A. §472(c).
 37. 21 V.S.A. §472(f).
 38. 21 V.S.A §618(b).
 39. 21 V.S.A. §601(13) and (14)(C).
 40. 21 V.S.A. §601(14)(D).
 41. *Wentworth v. Fletcher Allen Health Care*, 171 Vt. 614 (2000).
 42. 21 V.S.A. § 643b.
 43. 21 V.S.A. § 701.



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44. O'Boyle v. Parker-Young Co., 95 Vt. 58, 112 A. 385 (1921).
45. Adams v. Green Mountain Railroad Company, 2004 VT 75, 862 A.2d 233 (2004); Payne v. Rozendaal, 147 Vt. 488, 491, 520 A.2d 586, 588 (1986).
46. *Id.*
47. Payne v. Rozendaal, 147 Vt. 488 (1986).
48. LoPresti v. Rutland Regional Health Service, Inc. 2004 VT 105; 865 A.2d 1102 (2004).
49. 21 V.S.A. §495(a)(5).
- 50.
51. Dillon v. Champion Jogbra, Inc. 175 Vt. 1, 819 A.2d 703 (2002).
52. *Id.* See also Havill v. Woodstock Soapstone Co. 172 Vt. 625, 783 A.2d 423 (2001) and Ross Times Mirror, Inc. 164 Vt. 13, 665 A.2d 580 (1995) and Farnum v. Brattleboro Retreat, Inc. 164 Vt. 488, 671 A.2d 1249 (1995).
53. 9 V.S.A. §4469.

Chapter VI: Water Quality and Environmental Regulation

1. 6 V.S.A. §§ 4810 - 4812.
2. 6 V.S.A. §4810.
3. 6 V.S.A. § 4810(a)(1).
4. 6 V.S.A. §4812.
5. *Id.* §§ 4815, 4826; *Natural Resources Conservation Service Practice Standard: Waste Storage Facility* (313)-1, <http://efotg.nrcs.usda.gov/references/public/NE/ACFE75.pdf>, (July, 2002).
6. 6 V.S.A. § 4815(a).
7. 6 V.S.A. § 4815(b).
8. 6 V.S.A. §§ 4849 – 4861.
9. *Id.* §§ 4851(a), 4857.
10. *Id.* §§ 4851 – 4855; *Large Farm Operation Regulations*, Subchapter 7 1(f), 2(a) (1999), www.vermontagriculture.com/lforules.htm#Subchapter%207.
11. <http://www.vermontagriculture.com/lforules.htm#Subchapter%201>.
12. 6 V.S.A. § 4851(e).
13. LFO Regulations, subchap. 5, § 3(b)(2).
14. 6 V.S.A. §§ 4856 – 4861.
15. *Id.*
16. 33 U.S.C. §§ 1311(a), 1319, 1342(a)-(d), 1362, 1365(a).
17. *Id.* § 1362; 40 C.F.R. § 122.2.
18. 40 C.F.R. § 122.23.
19. 40 C.F.R. § 122.23(a) – (c).
20. A 25 year 24 hour rainfall event is the maximum probable precipitation given a recurrence interval of once in 25 years as defined by the National Weather Service in technical paper no. 40, "Rainfall Frequency Atlas of the United States," May, 1961 or equivalent regional or State rainfall probability information. 40 CFR §422.41(e).
21. 40 C.F.R. §122; 123; 412.
22. 33 U.S.C. § 1369(b); 10 V.S.A. §§ 1269 – 1270.
23. Lake Champlain Phosphorus TMDL at 4.
24. *Fact Sheet Lake Champlain Phosphorus TMDL*, Vermont Department of Environmental Conservation (2002).
25. <ftp://ftp-fc.sc.egov.usda.gov/VT/Outreach/CIGMagnanReleaseSept.2004.pdf>.
26. <http://www.nrcs.usda.gov/programs/cig/2004grants.html>.
27. <http://www.nrcs.usda.gov/programs/cig/CIG-KP1-05.pdf>.
28. <http://www.environmentaldefense.org/article.cfm?contentid=3348>.
29. Lance Gorham – NRCS (802-334-6090 x24). http://www.vt.nrcs.usda.gov/programs/EQIP/EQIP2005/EQIP2005_Vermont.html.
30. <http://www.vermontagriculture.com/Agriview%20Online/Agriview%20021503/agriviewonline9.htm>.
31. <http://www.lcbp.org/factsht/wetlands.pdf>; <http://www.nrcs.usda.gov/programs/farm-bill/2002/pdf/WRPfct.pdf>; Kip Potter – NRCS (802-951-6796 x 238); <http://www.nae.usace.army.mil/news/2004-76.htm>.
32. <http://www.samesessenger.com/121104.html>;
33. <http://www.nrcs.usda.gov/programs/crp/>;
34. http://www.fsa.usda.gov/vt/VT_FSA_2004.htm.
35. <http://www.anr.state.vt.us/cleanandclear/agcrep.htm>; Laura Hanrahan –CREP Coordinator (802-828-1289).
36. http://www.nrcs.usda.gov/programs/csp/pdf_files/CSP_%20brochure.pdf;
37. http://leahy.senate.gov/issues/Agriculture/farm-bill/TheFarmBill_files/Conservation.htm;
38. http://www.nrcs.usda.gov/programs/csp/2005_CSP_WS/CSP_Junelist.pdf;
39. http://www.vt.nrcs.usda.gov/programs/CSP/CSP_2005/VT%202005%20CSP%20Tier%20Eligibility.html;
40. <http://www.nrcs.usda.gov/pro>



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grams/farmbill/2002/pdf/CSP_fact_sheet_604.pdf; <http://www.vt.nrcs.usda.gov/news/CSP%20Open%20March,%202005.pdf>; Heather Cecchinato – Resource Conservationist (802-951-6796 x 223).

31. http://www.fsa.usda.gov/vt/VT_FSA_2004.htm; http://policy.nrcs.usda.gov/scripts/lpsiis.dll/M/M_440_521_A_10.rtf; Ann Hillard.

32. Matt Kittredge– Medium Farm Operations Coordinator (802-828-6908); <http://www.anr.state.vt.us/cleanandclear/overviewprnt.htm>.

33. Robert Achilles -Agricultural Engineer (802-828-6510).

34. Robert Achilles -Agricultural Engineer (802-828-6510).

35. <http://www.cvps.com/cowpower/faq.shtml>.

Chapter VII: Farm Insurance

For more information on crop and other insurances, as well as other ways to manage risk, please visit the USDA Risk Management Agency website.

Chapter VIII: Regulation of Organic Agriculture

1. 18 U. S. C. §1001.

2. See *Harvey v. Veneman*, 396 F 3d 28 (2005).

Chapter IX: Regulation of On-Farm Food Processing and Marketing

1. 21 C.F.R. §110.80.

2. GAPs are distinct from Best Management Practices (BMPs) and Accepted Agricultural Practices (AAPs.) While BMPs and AAPs are focused on preserving water and soil quality, GAPs are designed to reduce microbial contamination of fruits and vegetables.

3. Improving the Safety and Quality of Fresh Fruits and Vegetables: A Training Manual for Trainers, University of Maryland/FDA Joint Institute for Food Safety and Applied Nutrition, p. II-2.

4. See CF 120.06.

5. <http://www.vtcheese.com>.

6. 6 V.S.A. §2701(a), Introduction.

7. 3 V.S.A. §2701.

8. 6 V.S.A. §2701(a), Item 1p.

9. *Id.* Item 2p.

10. *Id.* Item 5p.

11. *Id.* Item 6p.

12. *Id.* Item 8p.

13. *Id.* Section 12.

14. 6 V.S.A. §2721.

15. 6 V.S.A. §2672(6).

16. 6 V.S.A. §2723(3).

17. 6 V.S.A. §2723(3).

18. 6 V.S.A. §2721(b), (c).

19. 6 V.S.A. §2672(4).

20. 6 V.S.A. §2741.

21. 6 V.S.A. §2672(3).

22. 6 V.S.A. §§2741, 2742.

23. 6 V.S.A. §2744(b).

24. 6 V.S.A. §2678.

25. 6 V.S.A. §2744.

26. ANR Wastewater System and Potable Water Supply Rules §1-102(a)(1) (2005).

27. *Id.* §1-201(46).

28. *Id.* §1-201(63).

29. *Id.* §1-101(a).

30. *Id.* §1-302(b).

31. *Id.* §1-313.

32. Wastewater System & Potable Water Supply Permit Applications can be found at <http://www.anr.state.vt.us/dec/ww/permits/WWApplication.pdf>.

33. *Id.* §1-102(a)(7).

34. *Id.* §1-309(a).

35. *Id.* §1-311(a).

36. *Id.* §1-404(a)(1).

37. *Id.* §1-404(a)(1-10).

38. To locate the appropriate Regional Engineer, see http://www.anr.state.vt.us/dec/permit_hb/anrregmap.htm.

39. *Id.* §1-316.

40. *Id.* §1-306(b).

41. *Id.* §1-314(a).

42. ANR's Vermont Guidelines for Land Application of Dairy Processing Wastes, August 14, 1990. Available online at <http://www.anr.state.vt.us/dec/ww/indirect.htm>.

43. 10 V.S.A. §1267.

44. 10 V.S.A. §1274.

45. 10 V.S.A. §1274.



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