



AGRICULTURAL LAW AND TAXATION BRIEFS

DEPARTMENT OF AGRICULTURAL AND CONSUMER ECONOMICS, UNIVERSITY OF ILLINOIS AT URBANA-CHAMPAIGN

PROTECTING A FARM TENANT'S RIGHT TO COMPENSATION FOR IMPROVEMENTS MADE TO THE LEASED FARM IN ILLINOIS

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Synopsis: This article summarizes “the law of removable fixtures and permanent improvements” in the context of Illinois farm leases. It also encourages tenants to be very cautious about paying for improvements to rented land. If a tenant decides to pay for such improvements, the article suggests ways to assure fair compensation to the tenant for the un-depreciated value of improvements made by the tenant at tenant’s expense (e.g., grain storage built on the rented farm, drainage improvements to the rented farm, lime applied on the rented farm by the tenant). This article is part of a law-related educational program for Illinois family farmers made possible by a gift from the Illinois Bar Foundation. The assistance of the Agricultural Law Section Council of the Illinois State Bar Association in reviewing and otherwise assisting with the preparation of the article also is appreciated.

Overview of Issues/Purpose of Article

Suppose Tenant desires additional on-farm grain storage or improved drainage on a rented farm. If Owner is unwilling to make the improvement, Tenant *may* be willing to make the improvement at Tenant’s expense provided there is assurance of fair compensation if Tenant must leave the farm before the improvement had been fully depreciated.

Suppose a rented farm needs limestone. If Owner is unwilling to incur this expense, Tenant *may* agree to pay for the limestone even though the benefits of the limestone application may extend beyond Tenant’s lease term. This can be especially problematic if Tenant is operating under a one year lease, and Tenant has no assurance that the lease will be renewed for the following year.

Tenants should view such expenditures *with great caution* and not assume that the law will assure fair compensation if Tenant must leave the farm before receiving the full benefits from the expenditure.

The purpose of this article is threefold: *First*, to summarize “the law of removable fixtures and permanent improvements” in the context of farm leases. *Second*, to suggest ways in which the tenant might, by contract or special provisions in the lease, be assured of fair compensation for the un-depreciated value of permanent improvements made by the tenant (e.g., grain storage or drainage improvements installed on the rented farm by the tenant). *Third*, to suggest ways in which the tenant might be assured of fair reimbursement for expenditures creating multi-year benefits – benefits

that may not be fully realized during the tenant’s lease term (e.g., tenant’s expenditure for limestone).

The Law of Removable Fixtures and Permanent Improvements

Tenant’s right to remove fixtures. Whether a particular improvement constructed on the leased premises by a tenant can be removed by the tenant at the expiration of the lease may depend on whether that improvement is classified as a “removable fixture” or a “permanent improvement.”

If it is classified as a *fixture*, Illinois law allows the tenant to remove the fixture, provided (1) tenant does not owe back rent, (2) tenant placed the fixture on the land himself or herself, and (3) tenant removes the fixture before the expiration of the lease term.¹

On the other hand, if the improvement is classified as a *permanent improvement*, the landlord may have no obligation to compensate the tenant, absent some provisions in the lease or other binding agreement.²

The distinction between permanent improvements and removable fixtures is not always clear. Courts seem to view the intent of the parties as controlling. The intent is clear if the owner and tenant *expressly* state their intentions in the lease (or in some other written document signed by the parties).

Tenants right to compensation for permanent improvements. Other improvements like a grain bin or drainage tile are permanent improvements. If the

¹ See 735 ILCS 5/9-319, and related court decisions.

² See *Gardner v. Watson*, 18 Ill. App. 386 (1886).



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owner and tenant have agreed that the tenant is to make the improvement, then a special agreement is probably necessary to avoid the otherwise harsh rule about compensation. Remember, if the improvement is a *permanent improvement*, the farmland owner may have no obligation to compensate tenant, absent a special provision in the lease or other contract.

are intended to be removable and which are intended to be permanent. Finally, the agreement should state any compensation the owner agrees to pay the tenant for improvements remaining on the land when the tenant leaves, and the manner in which this compensation is to be computed.

Lease Provisions or Other Agreements Assuring Tenant Reasonable Compensation for Permanent Improvements

Because of the legal issues and the potentially large sums of money involved, legal counsel should be consulted regarding the special lease provision or other agreement addressing issues of compensation, etc. A provision in the lease forms on the *farmdoc* website (<http://www.farmdoc.uiuc.edu/>) provides a useful starting point. A variation of that lease provision (in the form of a lease amendment) appears immediately below.

The written lease, amendments to the lease, or some other binding agreement should state whether the tenant has a right to make A permanent improvement. The agreement also should state which improvements

Lease Amendment: Improvements made by Tenant at Tenant's own expense. When Owner and Tenant agree that Tenant may make all or part of an improvement (such as a grain bin, installation of drainage tile, major repairs, fences, etc.) to the farm at Tenant's own expense and that Tenant is to be reimbursed for any costs remaining at the end of the lease, the agreement shall be recorded on the following form and, after being duly signed by both parties, it shall become a part of the lease above and obligate the Owner and his or her heirs and assigns to make such reimbursement. Such improvements become the Owner's property upon completion of the form below. The Owner thereby assumes the responsibility for property taxes, insurance coverage, and risk of loss. Both Owner and Tenant should retain a signed copy of the agreement.

Description and location of the improvement that Owner is giving Tenant permission to make	Net cost to tenant	Annual rate of depreciation (percent)	Date depreciation begins	Signatures and Date Signed
				Owner: Tenant:

Lease Provisions Assuring Tenant Reasonable Compensation for Limestone, etc.

application at the rate of 25% for each subsequent growing season when Tenant farmed the land. After four such growing seasons, there is no "remaining cost" to be reimbursed.

Sometimes it may be preferred to state the tenant's right to reimbursement in the lease, itself. For example, a one year lease or a year-to-year lease in which a tenant agrees to apply limestone when needed (often, every four or five years) might also include a provision similar to the following:

Summary

At the end of this lease term, if Tenant does not remain in possession of the farmland under a new lease or lease extension, Owner agrees to reimburse Tenant for Tenant's "remaining cost" for each application of limestone made within the past four lease years, this year included. The Tenant's "remaining cost" for each application shall be calculated by depreciating Tenant's net cost of each

Farm tenants should be very cautious when making or paying for permanent or multi-year improvements to rented farmland. Legal counsel can help the tenant understand the legal implications and financial risks accompanying such expenditures. If the tenant still wants to proceed, legal counsel can advise the tenant regarding suitable lease provisions or separate agreements that would obligate the owner to compensate the tenant fairly if the tenant leaves the farm before the improvements made by the tenant have been fully depreciated.

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