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Testimony



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WATER SUBSIDIES

Views on Proposed Reclamation  
Reform Legislation

Statement of  
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Natural Resources Management Issues  
Resources, Community, and Economic  
Development Division

Before the  
Subcommittee on Water and Power  
Committee on Energy and Natural Resources  
United States Senate



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our views on legislative proposals to amend the Reclamation Reform Act of 1982. These proposals are intended to change provisions in the law that permit multiple landholdings, each of which is within the act's 960-acre limit, to continue to be operated collectively as one large farm while individually qualifying for federally subsidized water.

You asked us to analyze four bills: H.R. 429, passed by the House of Representatives on June 20, 1991; S.1501, introduced by Senator Burns and others; a bill drafted by the Department of the Interior's Bureau of Reclamation; and a bill drafted by you. For each of these bills, you asked us to determine whether the four case studies of farm operations discussed in our October 1989 report, as well as the one discussed in our June 1990 report, would continue to receive subsidized water on more than the legislatively-mandated 960 acres.<sup>1</sup>

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<sup>1</sup>Water Subsidies: Basic Changes Needed to Avoid Abuse of the 960-Acre Limit (GAO/RCED-90-6, Oct. 12, 1989).

Water Subsidies: The Westhaven Trust Reinforces the Need to Change Reclamation Law (GAO/RCED-90-198, June 5, 1990).

## BACKGROUND

The 1982 act limits the amount of owned and/or leased land that is eligible to receive federally subsidized water to a maximum of 960 acres. Our five case studies provide examples of how some farmers have reorganized their farms into multiple, smaller landholdings to be eligible to receive additional federally subsidized water using various partnerships, corporations, and/or trust arrangements. (See attachment I.)

In one case study, which we referred to as Alpha Farms in our 1989 report, a 12,345-acre cotton farm (roughly 20 square miles), operating under a single partnership, was reorganized into 15 separate landholdings through 18 partnerships, 24 corporations, and 11 trusts involving four families. In another case study, which we called Gamma Farms, four members of a family certified to the Bureau that the 4,638 acres they owned or leased were actually four separate landholdings. Similarly, a 1,569-acre citrus and almond orchard, which we referred to as Delta Farms, was reorganized into four smaller landholdings through four partnership and three limited partnership arrangements. In the fourth case, which we called Epsilon Farms, 10 family members had put their land into a revocable trust (one which they can dissolve at any time) that controlled 3,116 acres and made themselves beneficiaries of all income the trust would derive.

Our June 1990 report discussed the Westhaven Trust, a 23,238-acre farm operation which is irrigated with subsidized water. The J.G. Boswell Company, a large farm operator located in the Bureau's Central Valley Project in California, sold acreage of the Boston Ranch Company, a wholly owned subsidiary, to the Westhaven Trust, with the landholdings attributed to 326 of its salaried employees.

Common to all five of our case studies was the fact that, for all practical purposes, the smaller landholdings created by the reorganizations continued to be operated collectively as single large farms, much as they were before being reorganized. To illustrate this, our 1989 report identified 11 factors, any one or more of which could indicate that individual small landholdings are, in fact, parts of larger farms. (See attachment II.) In that report we recommended that the Congress amend the 1982 act to apply the act's acreage limit to farms and farm operations as well as to individual landholdings.

#### RESULTS IN BRIEF

Our analysis indicates that, if the farm operations portrayed in our case studies remain constant, each of the bills may limit federally subsidized water to some or all of the operations. Three of the farm operations may continue to receive subsidized water on more than 960 acres under both H.R. 429 and the Bureau's draft bill. Four of the five operations may be eligible to receive

additional subsidized water under S.1501. Your bill, Mr. Chairman, may discontinue subsidized water to more than 960 acres in all five cases.

However, farmers have ample financial incentive to reorganize their operations in response to any new reclamation legislation enacted, and if history is any indication of what might be expected, some farmers are likely to reorganize again to be eligible to receive additional federally subsidized water. Therefore, we believe that any amending legislation enacted by the Congress should be as clear as possible in limiting the acreage on which a farm or farm operation is eligible to receive federally subsidized water.

#### ANALYSIS OF LEGISLATIVE PROPOSALS

Let me now address how the five case studies would fare under each of the bills.

##### H.R. 429

Under H.R. 429, three of the five large farm operations in our case studies may continue to receive subsidized water on land in excess of the 960-acre limit. While the bill defines farm and farm operation and identifies factors which indicate that a farm or farm operation exists, it excludes some of these factors in

determining their existence. For example, the bill excludes financial transactions. We used two financial transactions, together with other factors, to determine that Delta Farms was operating as a single, large farm.<sup>2</sup> In addition, the bill excludes custom farming or farm management agreements from consideration so long as custom farmers and/or farm managers do not bear a direct interest in the crop. Because in the Delta case study the farm managers did not clearly bear a direct interest in the crop, this factor may also be lost under the bill. With three of the four factors in the Delta case removed from consideration, it may not be considered a farm operation.

Section 202(3)(C) of the bill provides with respect to related parties that the Secretary of the Interior shall certify that a farm or farm operation does not exist if activities between such parties are entered into and performed at arms length. In the report that accompanied this bill, arms length is defined to mean an agreement negotiated between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of all relevant facts. We believe that because the families in the Alpha and Gamma case studies may have been able to supply information at least suggesting arms-length

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<sup>2</sup>These two factors were (1) the four partnerships had a single operating loan with all four landholdings used as collateral and (2) each partnership agreed to cover the mortgage loan defaults of the other partnerships.

agreements among themselves, they would not have been considered farm operations.

H.R. 429 would, however, require the Westhaven Trust to pay full cost for all its water and the Epsilon family trust to pay full cost for all water delivered to land in excess of 960 acres, phased in over 3 years.

#### S.1501

Four of the five large farm operations might be able to continue to receive subsidized water on more than 960 acres under S.1501. The bill defines a farm operation as all land with common ownerships or leases, through which an individual or legal entity owns or leases, with any other individual or entity, more than 50 percent of two or more tracts of land. This could permit large farms to exist so long as the individuals or entities owned or leased less than 50 percent of two or more tracts of land.

The bill also includes exemptions for active farmers, defined as individuals or legal entities which acting through their employees or owners, devote at least 500 hours in a calender year to activities that benefit the land or are critical to the profitability of the farming enterprise. Under the bill, active farmers can combine their 960-acre landholdings into a single operation and still receive subsidized water on all of the land.

S.1501 specifies that an operation benefitting more than 25 individuals cannot receive subsidized water on more than 960 acres. However, it would be possible for farm operations consisting of 25 active farmers to receive subsidized water on all of their combined 24,000 acres. We believe that if the farmers in all of our case studies, except the Westhaven Trust, could demonstrate that they fall within the bill's definition of an active farmer, they would continue to receive subsidized water on landholdings in excess of 960 acres.

The Westhaven Trust would not continue to receive subsidized water on all of its acreage because of the bill's limitation on operations benefitting more than 25 individuals, but could irrigate 960 acres with subsidized water.

#### The Bureau of Reclamation's Draft Bill

Three of the large farm operations in our case studies could continue to receive subsidized water on land in excess of the 960-acre limit under the Bureau of Reclamation's draft bill. The bill does not include a definition of farm or farm operation or any factors which indicate that a farm or farm operation exists.

The bill applies acreage limitations to the legal entity that performs the major role in making decisions and doing or supervising the work on a farm. However, as we testified before



your subcommittee last year, it is sometimes difficult to identify the legal entity or individual performing the greatest proportion of the decisionmaking or supervision. For example, in the Alpha case, four individuals made the management decisions for 9 of the 15 landholdings comprising the 12,345-acre cotton farm, and it would be difficult to ascertain which of the four was responsible for the greatest proportion of the decisionmaking.

The 1982 act prevents legal entities benefitting more than 25 individuals, established after October 1, 1981, from receiving any subsidized water. Since the Bureau's bill applies the same acreage limitations to trusts as to other legal entities, it would prevent the Westhaven Trust from receiving any subsidized water and the Epsilon trust from receiving subsidized water on more than 960 acres. These provisions would become effective on February 1, 1996.

#### Senator Bradley's Draft Bill

Your draft bill, Mr. Chairman, may stop the flow of federally subsidized water to more than 960 acres in all five of our case studies. The bill defines farm and farm operation and identifies the factors which indicate that a farm operation exists. The bill, however, applies the acreage limitations directly to landholdings and only indirectly to farm and farm operations. This

indirect applicability to farm operations could cause some confusion and lack of clarity in implementing these limitations.

As in the Bureau's draft bill, your bill applies the same acreage limitations to trusts as to other legal entities and would prevent the Westhaven Trust from receiving any subsidized water. The Epsilon trust would be prevented from receiving subsidized water on more than 960 acres after 3 years.

The bill's provisions relating to farms or farm operations would not apply in at least 11 of the 17 western states receiving Bureau water because the bill omits states or projects in which the average gross crop value in 1988 was \$800 or less per acre. The net result is that these provisions primarily will affect farm operations in California, Arizona, and Washington.

#### LEGISLATIVE PROPOSALS MAY NOT

#### PRECLUDE FUTURE REORGANIZATIONS

While each of the legislative proposals may limit federally subsidized water to some or all of the operations in our case studies, we believe that some farmers are likely to reorganize their operations again in response to whatever new legislation is enacted by the Congress. For example, each of the bills prevents large trusts such as the Westhaven Trust from continuing to receive subsidized water on all their land. However, the trust could

reorganize into smaller entities or trusts with separate mortgages, and each could then hire the Boston Ranch Company to farm the land. If each party enters into an operating agreement at arms length with the Boston Ranch Company, all 23,238 acres might be able to continue to receive subsidized water while being operated by the same company. Therefore, we believe that any amending legislation enacted by the Congress should be as clear as possible in limiting the acreage on which a farm or farm operation is eligible to receive federally subsidized water.

To do this, we believe that the amending legislation should include a clear statement of purpose to provide the Bureau guidance in implementing the new law. As we reported in October 1989, one of the shortcomings of the Reclamation Reform Act of 1982 is that it contains no stated purpose to guide the Secretary's administration and interpretation of the act. Such a statement might say that the purpose of the legislation is to stop the flow of federally subsidized water to owned and/or leased land over a maximum of 960 acres, or whatever limit may be established, and that multiple landholdings being operated collectively as one large farm cannot, in any event, receive subsidized water on more than the established acreage limit.

We also believe that any factors or indicators explicitly excluded from consideration in determining the existence of a farm or farm operation should be clearly defined. Further, if certain

factors are to be excluded from consideration in determining the existence of a farm or farm operation, the exclusion should only apply to consideration of the factors individually and not to their consideration in conjunction with other factors.

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Mr. Chairman, this concludes my statement. We would be pleased to respond to any questions you or the Subcommittee members may have.

TYPES OF REORGANIZATIONS AND ARRANGEMENTS: FIVE CASE STUDIESCase I: Alpha Farms

In this case, a 12,345-acre farm (roughly 20 square miles) was reorganized into 15 separate landholdings, through an elaborate network of partnerships, corporations, and trusts involving four families. Five indicators showed that after the farm was reorganized, the 15 landholdings continued to be operated as one large farm:

- one partnership leased 12,345 acres, and then subleased portions of it to other new partnerships;
- the partners<sup>1</sup> obtained one operating loan secured by the farms' crops and other assets;
- crop subsidy records indicate that the landholdings are interrelated;
- two farm management companies operate all 15 landholdings; and
- four individuals make the management decisions for nine of the 15 landholdings.

Case II: Gamma Farms

In this case study, four members of a family--father, son, and daughter and her husband--each owned acreage and, together with

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<sup>1</sup>A "partner" in a given partnership can be a corporation, trust, individual, or even another partnership.

leased acreage, managed their landholdings as Gamma Farms partnership, a 4,638-acre farm. In July 1987, the Gamma family filed Bureau certification forms as four separate landholdings--one controlled by each of the family members and one by the Gamma Farms partnership. Each landholding consisted of less than 960 acres of class I-equivalent land,<sup>2</sup> allowing it to receive subsidized water on the entire acreage. However, the family continued to operate the four landholdings as one farm.

We identified the following indicators that showed that the Gamma Farms partnership continues to operate the 4,638 acres as one farm:

- the four landholdings were combined as collateral for an operating loan;
- a single farm management company owned by the Gamma family operates all four landholdings;
- the farm manager acknowledges that the landholdings are being operated as one farm; and
- the farm manager bears an economic risk in the operation of more than 960 acres.

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<sup>2</sup>The 1982 act recognizes that there are differences in the potential productivity of the land on which federal irrigation water is delivered and provides for acreage equivalency determinations. Class I land has the potential to be the most productive. A farmer can irrigate up to 960 acres of class I land with federally subsidized water.

Case III: Delta Farms

In another case study, a 1,569-acre citrus and almond orchard was organized into four smaller landholdings through four partnership and three limited partnership agreements. Four indicators showed that these four landholdings continue to be operated as one large farm:

- the four partnerships had a single operating loan with all four landholdings used as collateral;
- each partnership agreed to cover the mortgage loan defaults of the other partnerships;
- one general partner (shared by all three limited partnerships) made the management decisions for the four landholdings; and
- the farm operator bore an economic risk in operating the entire 1,569 acres.

Case IV: Epsilon Farms

A fourth case study involves a 3,116-acre Epsilon family farm that was receiving subsidized water before the act's acreage limits took effect. The family placed their owned land in a trust. Although the family farmed less than 960 acres in 1987, the trust they established enables them to irrigate all 3,116 acres with subsidized water in the future. According to both the trustee and the attorney who arranged the trust, one of the reasons the Epsilons formed the trust was to provide the family the option of operating all the acreage as one farm without paying the full-cost

rate for any irrigation water. The Reclamation Reform Act exempts from its acreage limits lands held for beneficiaries by a trustee in a fiduciary capacity as long as no one beneficiary's interest exceeds the law's ownership limits.

Case V: Westhaven Trust

The J.G. Boswell Company's Boston Ranch is another example of a large farm, reorganized by its sale to the Westhaven Trust, to whose beneficiaries are attributed multiple, individual landholdings. Each landholding is within the act's 960-acre limit, and each individually qualifies for federally subsidized water under current reclamation law. We identified the following five indicators that demonstrate to us that, after the Boston Ranch was sold to the Westhaven Trust, the acreage has continued to be operated as one large farming operation.

- One of the stated purposes of the trust is to operate the entire acreage as one farm under a farm management agreement. Officials from the J.G. Boswell Company and the Westhaven Trust acknowledge that the Westhaven Trust land is generally operated as one farm.
- The 23,238 acres were purchased with one loan.
- The trustee makes management decisions for the entire acreage.
- The annual farming operation is financed with one operating loan.



-- The beneficiaries have an undivided interest in the land. In other words, no individual beneficiary owns a specific parcel of land. Rather, each beneficiary is allocated a percentage of the total acreage of the trust.

LIST OF FACTORS THAT COULD BE  
USED TO INDICATE THAT MULTIPLE  
LANDHOLDINGS ARE PARTS  
OF A LARGER FARM

- o The individual landholdings or other farm assets are combined as collateral for loans.
- o The principal owners or lessees of the individual landholdings agree to cover loan defaults of other principals.
- o The farm manager or operator bears an economic risk associated with the production and sale of the crops.
- o The same individuals make management decisions for multiple landholdings.
- o The owners of the farm management company that operates the small landholdings are the same individuals who owned or leased the land before the reorganization occurred.
- o The small landholdings are leased from the large farm that existed before the reorganization.
- o The same individuals own or lease the small landholdings.
- o A single farm management company operates multiple landholdings.
- o Crop subsidy records indicate that the landholdings are interrelated.
- o The small landholdings share equipment or labor, sometimes without charge.
- o The farm manager or operator acknowledges that the small landholdings are being operated collectively as one farm.