Agricultural Losses

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Investors intending to use agricultural land for purposes not associated with agriculture, like industrial, commercial development or mining, will very likely deal with compensation of so-called agricultural losses. Agricultural losses are a kind of compensation to the local and central budgets for loss of agricultural land as a valuable national asset. Notably, this charge also applies where agricultural land is going to be rezoned— independently whether it is held by the state, municipality or privately. Agricultural losses are due when the agricultural land ceases to be agricultural.

Agricultural losses are a legal phenomenon inherited from Soviet times that can barely be found in any other jurisdiction. Its nature is pretty ambiguous and rather frustrating for investors, especially as agricultural losses may sometimes reach millions of Hryvnias.

Agricultural losses due to non-agricultural land use

Compensation of agricultural losses is regulated by two key documents: the *Land Code of Ukraine* (the *Land Code*), Articles 207-209; and the *Decree* of the Cabinet of Ministers of Ukraine *On the Amount of and Procedure for Calculation of the Reimbursable Agricultural and Forestry Losses No.1279 of 17 November 1997* (Decree 1279). In reality the issue is regulated only by a handful of rules.

Pursuant to Article 207, section 2 of the *Land Code*, compensation is due for the loss of agricultural land (arable lands, perennial plants, fallow lands, hayfields and pastures) as the principal means of production in agriculture in the result of withdrawal (purchase) of such lands for purposes not associated with agricultural production.

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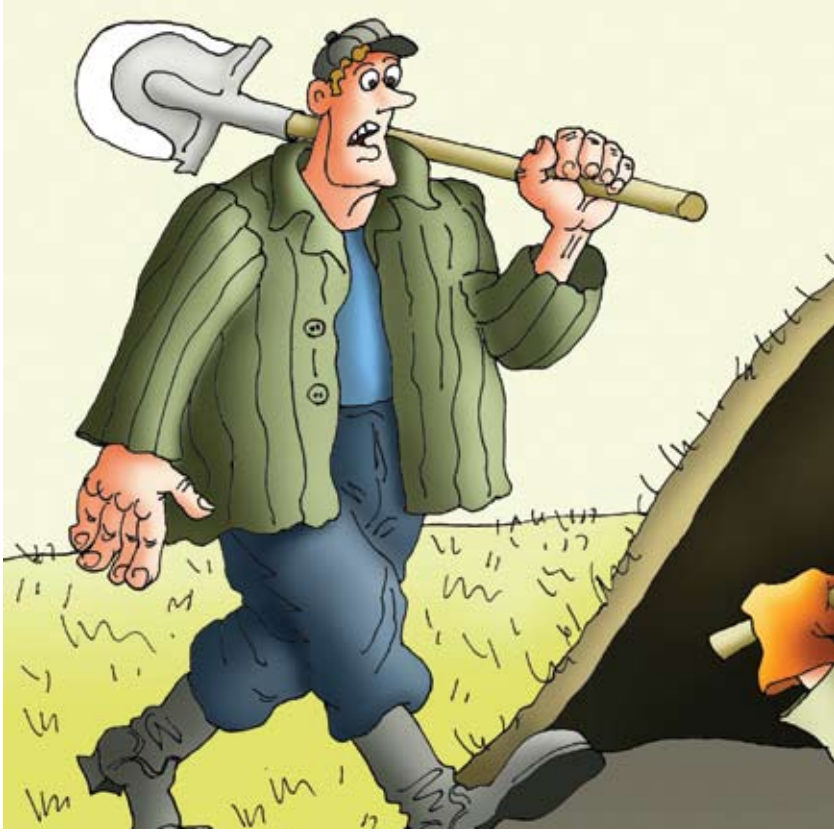
In practical terms this norm applies: (1) where investors acquire an agricultural land plot from the state or municipality, but intend to use it for non-agricultural purposes, e.g. development, extraction of mineral resources etc.; (2) in case of changing the designated purpose of land from agricultural to another land category, e.g. lands of commercial or industrial designation.

In both cases a so-called land allocation project has to be developed, which *inter alia* includes calculation of agricultural losses. The losses have to be paid to the respective budgets within two months after approval of the land allocation project (except for open-cast mining, where compensation follows gradually).

It is worth noting that agricultural losses are not damages, as they are compensated irrespective of (most often — in addition to) compensation of damages to the land owners and users per Articles 156-157 of the *Land Code* [see also Resolution of the Plenum of the Supreme Court of Ukraine *On the Practice of Application by Courts of Land Laws*



when Considering Civil Cases No.7 of 16 April 2004].

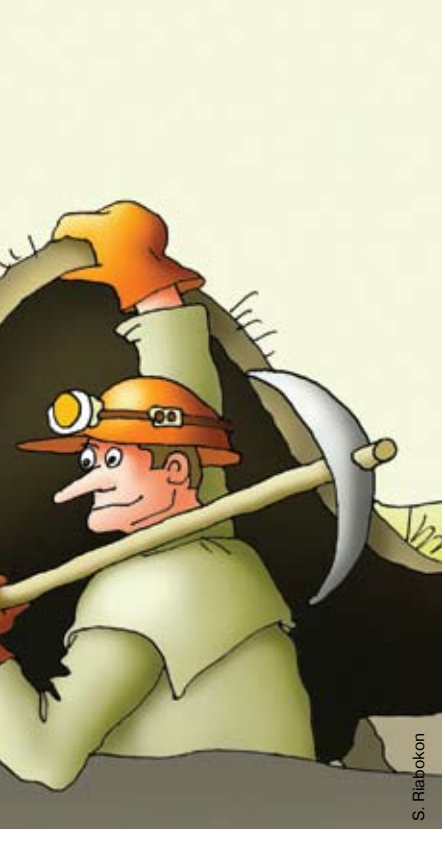
Nor are agricultural losses associated with harm to the environment or the ecosystem, as comparable charges are understood in European countries.

In Ukraine the concept of agricultural losses rests on the assumption that any (even virtual) "loss" of agricultural land plots (state, municipal or private) is an injury to the national agricultural sector; and the state must be compensated for it.

Land ownership and lease: when is a land plot really "lost" for agriculture?

In compliance with Article 207, section 2 of the *Land Code*, compensation of agricultural losses is conditioned by the "loss" of agricultural lands as a result of withdrawal (purchase) of the same for purposes unrelated to agricultural production.

However, neither Article 207 of the *Land Code*, nor Decree 1279 expressly distinguishes between allocation of land plots into ownership or temporary use (lease).



Where agricultural land is withdrawn from agriculture and allocated into ownership, this entails an irreversible loss of land for agriculture

It is no coincidence that the Higher Commercial Court of Ukraine emphasized that when adjudicating disputes regarding compensation of agricultural losses courts must "... ascertain and take into account circumstances which confirm permanent or temporary use of land, designated purpose after exploitation [...] and its actual designation, the category of land, possibility of resumption and further efficient use" [Resolution of the Plenum *On Certain Issues of the Practice of Consideration of Disputes Arising with regard to Land Relations No.6 as of 17 May 2011*].

Where agricultural land is withdrawn from agriculture and allocated into ownership, this entails an irreversible loss of land for agriculture. In such case there are grounds for compensation of agricultural losses per Article 207, section 2 of the *Land Code*. The calculation is done to the fullest extent — i.e. per the formula provided in section 1 of Decree 1279.

This begs the question whether compensation of agricultural losses is due when land is temporarily leased out for non-agricultural needs. Is the land plot considered as "lost" (withdrawn) in this case and, if so, will the loss be calculated in the same manner as in the event of permanent withdrawal?

Supervising authorities, in practice, attempt to calculate the losses with respect to leased land plots to the fullest extent — as if they were withdrawn irreversibly, even though upon expiry of the lease such land plots have to be returned as agricultural. Such an approach is knowingly unfounded. What is decisive for agricultural losses according to Article 207, section 2 of the *Land Code* is the fact whether the loss of land is irreversible for agriculture.

While allocating agricultural land for temporary use (lease) for non-agricultural needs, two options are possible:

(a) The terms and conditions of the lease do not provide for return of the land plot back into the agricultural pool upon expiry of the lease. For example, the land plot is allocated for construction of real estate facilities. Here the land plot may as well be regarded as withdrawn and irreversibly lost for the agricultural sector. Hence, there are valid grounds for compensation of the agricultural losses pursuant to Article 207, section 2 of the *Land Code*, and calculation should be performed to the fullest extent (per the formula referred to in section 1 of Decree 1279);

(b) The terms and conditions of the lease provide for placement of the land plot back into the agricultural pool upon expiry of the lease. For example, the land plot is conveyed into lease for mining purposes, after which it must be restored to a condition fit for arable agriculture. In this case there are no grounds to demand compensation of agricultural losses per Article 207, section 2 of the *Land Code*.

As an exception to the above, agricultural losses must be compensated when a leased land plot is returned with a poorer value (section 3, paragraph 2 of Decree 1279). A reduction in value means that the land will remain agricultural, but its composition will change. For example, arable land (more valuable land) will be converted into pasture (less valuable). In the case at hand the Ukrainian agriculture loses one land plot — that is arable land, but acquires other land in its place — pasture. In this case there are sound grounds for compensation of agricultural losses. However, the losses should be calculated not to the fullest extent, but rather as a difference (section 3, paragraph 2 of Decree 1279).

For these purposes the losses are determined both for initial, more valuable lands (arable lands), and for less valuable (pastures) — each time using the formula provided in section 1 of Decree 1279. The difference between the two would be subject to compensation.

Agricultural losses due to deterioration of land quality

Another type of agricultural losses envisaged in the *Land Code* (Article 207, section 3) are the losses caused by deterioration in the quality of land. In essence they differ from agricultural losses under Article 207, section 2 of the *Land Code* (described above), as do the grounds of and procedure for their payment.

Public authorities sometimes frivolously substitute these two types of agricultural losses. They can charge the losses due to dete-

rioration of the land quality (Article 207, section 3 of the *Land Code*) already at the stage of land allocation — alleging that any non-agricultural land use is detrimental and results in the deterioration of soil fertility, chemical composition, etc.

Such an approach contradicts the *Land Code* and Decree 1279. The basis for charging the agricultural losses under Article 207, section 3 of the *Land Code* is the fact of deterioration of the land quality as a result of a negative anthropogenic impact. That is, actual infliction of damage to land. The very fact of deterioration must be validly established and confirmed by detailed soil tests.

Unfortunately, Decree 1279 also lacks clarity in this regard. For instance, section 3, paragraph 2 of Decree 1279 stipulates the obligation of a lessee to pay agricultural losses where the agricultural land of poorer value is returned upon expiry of the lease. What first springs to mind relying on contextual construction of this norm, is that the "poorer value" implies deterioration of the land quality. This is, however, not the case — it is not about the deterioration of the qualitative characteristics of soil, but rather the quantitative loss of land for the agricultural sector. What, at first, may seem as a minor shortcoming of the law in practice results in abuses by public authorities, which often calculate the agricultural losses with significant overstatement.

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Thus, at the stage of land allocation one has to clearly distinguish between agricultural losses to be calculated for deterioration of the soil and those to be calculated for return of land with a poorer value.

Revegetation

When leasing agricultural land plots for non-agricultural purposes the terms and conditions of lease can require the lessee to carry out, at their own expense, revegetation of the land plot in order to rebuild the fertile soil. This applies particularly to the leasing of agricultural land for mining purposes. When a land lessee is obliged to reclaim new land or improve existing land, collectable agricultural losses must be decreased by the expenses made for revegetation of land.

In practice, this provision is often ignored, even though the cost of revegetation can be much higher than the agricultural losses themselves. Articles 207-209 of the *Land Code* imply that the revenues accumulated through collection of agricultural losses should be further invested by the government into revegetation, improvement and protection of lands. Where a land user is required to reclaim new land or improve existing land on their own, it is fair enough that such expenses must be taken into account when calculating agricultural losses.

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