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An Agricultural Law Research Article

**The South Dakota Family Farm Act of  
1974: Salvation or Frustration for  
the Family Farmer?**

by

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# THE SOUTH DAKOTA FAMILY FARM ACT OF 1974: SALVATION OR FRUSTRATION FOR THE FAMILY FARMER?

*Spurred by fears of a conglomerate invasion of South Dakota agriculture, lawmakers have enacted legislation limiting the operations of farm corporations. Various exceptions to the law attempt to distinguish desirable from undesirable farm corporations. This comment will examine the effectiveness of the Family Farm Act as a means of banning objectionable farm corporations while still allowing the genuine family farmer the opportunity to incorporate.*

## INTRODUCTION

The Legislature of the state of South Dakota recognizes the importance of the family farm to the economic and moral stability of the state, and the Legislature recognizes that the existence of the family farm is threatened by conglomerates in farming. Therefore, it is hereby declared to be the public policy of this state . . . that . . . no foreign corporation, and no domestic corporation except as provided herein, shall be formed or licensed under the South Dakota Business Corporation Act for the purpose of owning, leasing, holding or otherwise controlling agricultural land to be used in the business of agriculture.<sup>1</sup>

The 1974 South Dakota legislature, following the lead of other Midwestern states,<sup>2</sup> passed legislation severely restricting corporate farming. The stated purpose of the Family Farm Act of 1974<sup>3</sup> was to preserve the family farm against the threatened invasion of giant corporate farming enterprises with whom the small farmer could not compete.<sup>4</sup> The legislature recognized that the mutual dependency of farmers and small businessmen was of primary importance to the state's economy. Thus it felt that any threat to the financial well-being of the South Dakota farmer or rancher would have widespread economic repercussions on the state's economy as a whole.

In the last several years a number of farm spokesmen have voiced growing concern over the steady expansion of nonfarm investment in agriculture.<sup>5</sup> While present statistics for South Da-

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1. S.D. COMPILED LAWS ANN. § 47-9A-1 (Supp. 1974).

2. KAN. STAT. ANN. § 17-5902 (1974); MINN. STAT. ANN. § 500.24 (Supp. 1974); N.D. CENT. CODE § 10-06-01 (1960); OKLA. STAT. ANN. tit. 18, § 951 (Supp. 1974); WIS. STAT. ANN. § 182.001 (Supp. 1974).

3. S.D. COMPILED LAWS ANN. §§ 47-9A-1 to -23 (Supp. 1974).

4. *Id.* § 47-9A-1.

5. See, e.g., *Hearings Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business on the Effects of Corporation Farming on Small Business*, 90th Cong., 2d Sess. (1968) [hereinafter cited as 1968 *Hearings*].

kota do not reveal an alarming degree of nonfamily corporate farming operations, there does exist the distinct possibility for future expansion of conglomerate farming into the state. This comment will examine whether such fears have a basis in fact or whether farm corporations are merely being blamed for social and economic trends broader in origin than the presence of nonfamily corporate farms in agriculture.

While the South Dakota legislature limited the use of the corporation as a form of organization for farm businesses, it did not see fit to ban farm corporations altogether.<sup>6</sup> Instead, it attempted to draft legislation that would disallow only those corporations whose existence posed an economic threat to the family farmer. This comment will investigate the effectiveness of the Family Farm Act as a means of excluding large conglomerate farming operations while still granting the ordinary family farmer the opportunity to benefit from the advantages that the corporate form offers. In measuring the efficacy of the Act in preserving the family farmer, it will be necessary to identify the type of farm corporation the legislature sought to prohibit and distinguish its characteristics from the type of farm corporation which the legislature sought to preserve.

Particular attention will be given to two sections of the Act which allow the formation of what are termed family farm corporations<sup>7</sup> and authorized small farm corporations.<sup>8</sup> The family farm corporation section provides a means through which the bona fide family farmer can incorporate. In some respects it may be too restrictive and unduly hinder the farmer's business planning. Conversely, the provision establishing the authorized small farm corporation may prove to be a ready avenue for substantial nonfamily farm investment. It will be demonstrated that the Family Farm Act does not effectively ban all objectionable farm corporations and does not even attempt to limit noncorporate methods of farm investment; therefore, the comment will advance suggestions for strengthening the present law and will examine certain alternative legislative approaches.

#### SCOPE OF THE PROBLEM

##### *State and National Agricultural Trends*

Twentieth century technological advances in agriculture have greatly increased the productive capacities of the American farmer. Enlarged agricultural output has been accompanied by a significant change in the character of the American farm. The size of the average farm in South Dakota has increased from 781 acres in 1960

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6. S.D. COMPILED LAWS ANN. §§ 47-9A-4 to -15 (Supp. 1974).

7. *Id.* § 47-9A-14.

8. *Id.* § 47-9A-15.

to 1,046 acres in 1974,<sup>9</sup> while the total number of farms has decreased nearly twenty-six percent within the same period.<sup>10</sup>

National statistics magnify the state pattern. In absolute terms, farms on the average were 2.6 times larger in 1970 than fifty years before.<sup>11</sup> Between 1960 and 1970 the average American farm increased from 297 to 387 acres.<sup>12</sup> Similarly, the total number of farms has experienced a decline of 32.8 percent in the decade between 1960 and 1970.<sup>13</sup> Despite the increase in farm size, the actual number of laborers engaged in agricultural production has declined 36.4 percent in the same period.<sup>14</sup>

### *Farmers' Fears*

Leading advocates of legislation to curb corporate farming operations have regarded this decline in farm population as directly related to the increased presence of large corporate farming enterprises. In testimony before a Senate subcommittee Ben Radcliffe, president of the South Dakota Farmers Union, expressed his belief that:

The exodus from rural America has been brought about by two elements which go hand in hand: low farm prices and the increasing entrance into agriculture by giant, non-farm corporations . . . .

In addition, corporations, in general, do not make good Main Street customers or good neighbors. They contribute little to a community in the way of church or school endeavors and they also are making it extremely difficult for young farmers to get started in farming or to expand their present farm unit to an adequate size because the giant corporate farms are generally able and willing to pay more than the going price to get what they want.<sup>15</sup>

Farmers and residents of rural communities have testified that they fear that a trend away from the family farm unit to the large agricultural corporation will result in the permanent transformation of the independent, individual producer into the hired laborer. Displaced from the farm, the masses of rural people will only add to the congested and overcrowded urban centers of our nation.<sup>16</sup> Many residents of rural communities believe that the advent of widespread corporate farming will mean a resulting decline in the economic, social and educational well-being of thousands of smaller towns and cities in agricultural areas. At least one well-regarded study of two communities in the San Joaquin Valley in central

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9. SOUTH DAKOTA CROP AND LIVESTOCK REPORTING SERVICE, S.D. DEP'T OF AGRICULTURE, CROP REPORTING SERVICE BULLETIN 65 (1973).

10. *Id.*

11. Ball & Heady, *Trends in Farm Enterprise Size and Scale*, in *SIZE, STRUCTURE AND FUTURE OF FARMS* 44 (A. Ball & E. Heady eds. 1972).

12. *Id.*

13. *Id.* at 43.

14. *Id.* at 45.

15. 1968 *Hearings*, *supra* note 5, at 23, 25.

16. *Id.* at 23.

California lends credence to this view.<sup>17</sup> The study investigated the two farming communities of Arvin and Dinuba in the rich agricultural area of central California. Dinuba was surrounded by small family-sized farms while Arvin was located near large corporate-type farms. The research disclosed that the small farm community of Dinuba surpassed Arvin in such areas as volume of retail trade, city improvements, social recreation, churches and educational facilities.<sup>18</sup>

Family farmers also view with alarm economic competition from essentially nonfarm corporations which have begun to involve themselves in agricultural production in order to claim farm expenses which can be offset against other income<sup>19</sup> and which can later be recaptured as a capital gain which is subject to a much lower tax rate.<sup>20</sup> The average family farmer striving to make a profit feels he should not be forced to compete against conglomerates which regularly take farm losses as deliberate financial policy.<sup>21</sup>

### *Are Such Fears Justified?*

Despite pronouncements by leading farm spokesmen, it is not entirely clear that the availability of the corporate form to farmers has been a root cause of rural decline in South Dakota. While considering corporate farming legislation during the 1968 session of the South Dakota legislature, the Senate requested that the subject matter of the proposed legislation be assigned for interim study to the Legislative Research Council.<sup>22</sup> A portion of the final report compared agricultural trends in North Dakota and South Dakota.<sup>23</sup> Since 1932 North Dakota has prohibited all corporate farming except that engaged in by farmer owned cooperatives;<sup>24</sup> South Dakota

17. SENATE SPECIAL COMM. TO STUDY THE PROBLEMS OF AMERICAN SMALL BUSINESS, SMALL BUSINESS AND THE COMMUNITY, 79th Cong., 2d Sess. (Comm. Print 1946), reprinted in 1968 *Hearings*, supra note 5 at 295-441 and reprinted in *Hearings Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business*, 92d Cong., 1st, 2d Sess. pt. 3A, at 4465-4590 (1973) [hereinafter cited as ARVIN-DINUBA STUDY].

18. For an interesting history of the Arvin-Dinuba study including the various attempts by certain government officials and business interests to suppress and discredit its findings, see *Hearings Before the Subcomm. on Monopoly of the Senate Select Comm. on Small Business*, 92d Cong., 1st, 2d Sess. pt. 3, at 3887-3947 (1973) [hereinafter cited as 1972 *Hearings*].

19. INT. REV. CODE OF 1954, §§ 175, 180, 182. For a detailed examination of farm tax advantages, see Allington, *Farming as a Tax Shelter*, 14 S.D.L. REV. 181 (1969); Davenport, *Farm Losses Under the Tax Reform Act of 1969: Keepin' 'Em Happy Down on the Farm*, 12 B.C. IND. & COM. L. REV. 319 (1971).

20. INT. REV. CODE OF 1954, §§ 1202, 1222.

21. 1968 *Hearings*, supra note 5, at 25.

22. S. Res. No. 6, 43d Sess. S.D. Leg. (1968) reprinted in SOUTH DAKOTA STATE LEGISLATIVE RESEARCH COUNCIL, CORPORATE OWNERSHIP OF AGRICULTURAL LAND AND FARMING 28 (Aug. 15, 1968) (Staff Memorandum) [hereinafter cited as L.R.C. MEMO].

23. *Id.* at 19-25.

24. N.D. CENT. CODE § 10-06-01, 04 (1960).

had no restrictions on corporate farming at the time of the survey. On the assumption that the two states have similar economic, social, and political characteristics the council attempted to determine what effect corporate farming has had on South Dakota agriculture. Its report concluded that North Dakota's anticorporate farming law "has not significantly helped maintain the farm population, lower the farm tenancy rate, or maintain the number of farms."<sup>25</sup> For the period of 1932 to 1968 both states showed nearly identical percentage increases in the average farm size<sup>26</sup> and in the number of all farms operated by tenants.<sup>27</sup> Similarly, the total farm population in both states experienced the same steady decline.<sup>28</sup>

Thus the presence of farm corporations in South Dakota does not appear to have been a major cause of rural decline between 1932 and 1968. Certainly less favorable prices, higher production costs and rapid technological changes have contributed more to the decline in farm population than has the existence of farm corporations. A number of farm spokesmen have noted that farm income has fallen behind the rest of the economy at an alarming rate and cite the loss of profit in farming as the major factor forcing the farmer off the land.<sup>29</sup> The council's findings indicate that the decline in farm population is more closely related to a decrease in farm profit than to the presence of farm corporations.

As the number of large corporations engaging in farming increases, however, their significance as a factor in rural decline will also increase. Agricultural production by nonfamily farm units has been quite limited in South Dakota as compared with other states.<sup>30</sup> Should South Dakota experience an influx of nonfamily farms into the state similar to that of other states, there is little reason to believe that farms and rural communities would not suffer the same economic and social decay found in the 1946 study of the farming communities of Arvin and Dinuba.<sup>31</sup>

The author of the Arvin-Dinuba study has testified that he is convinced the results of the 1946 study will be found to be equally applicable to the corporate invasion of the Middle West in the 1970's.<sup>32</sup> South Dakota's present corporate farming law reflects this view. The Family Farm Act does not eliminate existing farm corporations but merely controls their growth.<sup>33</sup> The major objec-

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25. L.R.C. MEMO, *supra* note 22, at 25.

26. *Id.* at 22.

27. *Id.* at 23.

28. *Id.* at 24.

29. 1972 *Hearings*, *supra* note 18, pt. 3A, at 4256.

30. Family farm sales accounted for eighty-eight percent of all farm products sold in South Dakota, compared to California's twenty-one percent, Texas's forty-eight percent or Florida's twenty percent. Nikolitch, *The Individual Family Farm*, in *SIZE, STRUCTURE AND FUTURE OF FARMS* 255 (A. Ball & E. Heady eds. 1972).

31. ARVIN-DINUBA STUDY, *supra* note 17.

32. 1972 *Hearings*, *supra* note 18, pt. 3, at 3889, 3927.

33. S.D. COMPILED LAWS ANN. § 47-9A-5 (Supp. 1974).

tive of the legislation is to halt the future expansion of conglomerate farming into the state.

### *The Objectionable Farm Corporation*

Recent corporate farming legislation in South Dakota, Minnesota and Wisconsin has attempted to distinguish between the conglomerate farm corporation and the closely held, family farm corporation.<sup>34</sup> The laws in each state were aimed at preventing the influx of large farm corporations which would cause problems in rural areas while at the same time allowing the family farmer to employ the corporate form to his advantage if he so desires. An attempt, therefore, must be made to define an objectionable farm corporation. Characteristics most often mentioned in any definition of an objectionable farm corporation include the existence of large scale firms, conglomerate organization, absentee ownership or control, significant nonfarm investment, vertical integration and hired managers and laborers.<sup>35</sup>

Although not every objectionable farm corporation would exhibit all of these features, it is possible to envision the type of corporate farm the South Dakota legislature sought to prohibit. Such a farm corporation is owned or controlled by nonfarmers who supply the financial backing but do not participate in either farm management or labor. The farming operations of the corporation may be only a part of a widely diverse pattern of investment in other nonagricultural areas. Tax advantages rather than profit may be its primary goal. Crops and livestock produced by the farm corporation may be used as a supply source for manufacturing divisions of the same parent corporation. The objectionable farm corporation is not a retail customer of local businesses but buys at wholesale in distant markets.

A frequently used example of an objectionable farm corporation is the vertically integrated livestock operation.<sup>36</sup> Cattle are raised on the corporation's ranchland, fattened in the corporation's feedlot on grain from the corporation's cropland, slaughtered and processed in the corporation's packinghouse and finally sold in the corporation's supermarket. One giant conglomerate operating from feedlot to supermarket can easily duplicate the efforts of thousands of family ranch and farm units. An illustration of such practices is Tenneco Inc., "a huge conglomerate with 3.4 billion dollars in assets, that has told its stockholders that it is developing a food system

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34. MINN. STAT. ANN. § 500.24(1) (c) (Supp. 1974); S.D. COMPILED LAWS ANN. § 47-9A-14 (Supp. 1974); WIS. STAT. ANN. § 182.001(1) (a) (Supp. 1974).

35. Comment, *Proposed Anticorporate Farm Legislation*, 1972 WIS. L. REV. 1189, 1205.

36. Moore & Dean, *Industrialized Farming*, in *SIZE, STRUCTURE AND FUTURE OF FARMS* 214, 225 (A. Ball & E. Heady eds. 1972).

based on integration from seedling to supermarket."<sup>37</sup>

In contrast to the farm conglomerate is the family farmer or rancher who wishes to incorporate. The closely held farm corporation, despite its label, continues to be a family farm; only the business form has changed. Stock is held among the family members who become shareholder-employees of their corporation. Management decisions are made by the same individuals who made them before incorporation. The farmer or rancher who incorporates his business is still the same independent, community-minded citizen that he was as a sole proprietor or partner. Few of the objections voiced against the farm conglomerate are applicable to the family farm corporation. There is no absentee ownership or control. The family farm corporation is engaged in farming for a profit and ordinarily has limited nonfarm investments. Far from threatening rural life, the family farm corporation may well increase the viability of the family owned and operated farm.<sup>38</sup>

#### *The Extent of Corporate Farm Operations in South Dakota*

To measure the need for restricting farm corporations, it is necessary to examine the nature and extent of corporate holdings of agricultural land in South Dakota. Unfortunately, there has been no recent survey of farm corporations within the state. Thus a comprehensive description of the current degree of corporate farming in South Dakota will not be available until every corporation engaged in farming within the state has filed a report as required by the Family Farm Act.<sup>39</sup> However, studies conducted in 1968 by the South Dakota Farmers Union<sup>40</sup> and by South Dakota State University<sup>41</sup> are helpful in establishing the general pattern of corporate farming in the state.

The Farmers Union survey, conducted with the assistance of county assessors and the state Agricultural Stabilization and Conservation Service Office, revealed a total of 452 corporations owning agricultural land amounting to 1,633,529 acres or 3.6 percent of the 45,000,000 farm acres in South Dakota.<sup>42</sup> Fifty-six corporations listed out-of-state addresses and owned 312,987 acres

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37. 1972 *Hearings*, *supra* note 18, pt. 3, at 3877.

38. Harl, *The Family Corporation*, in *SIZE, STRUCTURE AND FUTURE OF FARMS* 270 (A. Ball & E. Heady eds. 1972); Harl, *Public Policy Aspects of Farm Incorporation*, 20 *BUS. LAW.* 933 (1965). In these articles the author maintains that the corporation is compatible with the family farm concept if managerial power remains in the operating farm family. The articles demonstrate that from an economic standpoint, the corporation represents an ideal form of business organization for the multimember family farm business. *Id.*

39. S.D. COMPILED LAWS ANN. § 47-9A-16 (Supp. 1974).

40. 1968 *Hearings*, *supra* note 5, at 27.

41. R. BERRY, *SOME CORPORATIONS THAT OWN FARM AND RANCH LAND IN SOUTH DAKOTA* (S.D. State Univ. Econ. Pam. No. 130 (1969) [hereinafter cited as BERRY]).

42. 1968 *Hearings*, *supra* note 5, at 27.



of South Dakota land.<sup>43</sup> Thus the number of farm corporations remains small in comparison to the total number of farms in South Dakota. Less than one percent of all farms were incorporated in 1968.<sup>44</sup> No precise statistics are available on the number of farm corporations that are family owned and operated. In testimony before a Senate subcommittee the president of the South Dakota Farmers Union estimated that no more than twenty percent of the total acres owned by the fifty-six out-of-state corporations surveyed were owned by family corporations.<sup>45</sup> However, an "examination of the seventy-seven largest domestic farm and ranch corporations in South Dakota suggests that virtually all are family-owned and operated."<sup>46</sup>

The operations of out-of-state corporations owning agricultural land in South Dakota were examined in another 1968 study.<sup>47</sup> It indicated that most nonresident corporations lease their land to independent farmers. The same study also examined ten in-state and five out-of-state corporations that were directly managing or operating their lands and not leasing to others. The findings indicated that most were cow-calf operations of approximately 13,000 acres with an acreage of 4.5 stockholders.<sup>48</sup> In thirteen of the fifteen firms studied, all of the stockholders were related.<sup>49</sup> Thus it does not appear that a significant number of objectionable farm corporations were present within the state at the time these surveys were conducted.

The trend toward utilizing the corporation in farming, however, is a fairly recent one. Only two of the fifteen out-of-state corporations surveyed were organized before 1960.<sup>50</sup> As this trend toward incorporating farm businesses increases, the likelihood of

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43. *Id.* at 19, 27. Some of the largest foreign corporations owning land in South Dakota at the time of the 1968 survey included: Western Cattle Co. of New York, 70,948 acres in two counties; Shur-Gro Irrigation Company of Clovis, New Mexico, 36,688 acres in four counties; Hickman & Jordan of Texas, 28,327 acres in one county; and the Norris Grain Co. of Illinois, 41,874 acres in two counties. *Id.* at 19.

44. L.R.C. MEMO, *supra* note 22, at 5.

45. 1968 Hearings, *supra* note 5, at 19.

46. Berry, *What's the Nature of Corporation Farms in South Dakota?* THE FARMER 57 (March 2, 1968) [hereinafter cited as Berry]. Berry examined the seventy-seven largest domestic farm and ranch corporations in terms of: 1) the size of the corporation as measured by the amount of authorized capital stock; 2) number of different family names on the original board of directors; 3) the number of directors with out-of-state addresses. The investigation revealed that of the twenty-four corporations authorized to issue over 500,000 dollars of capital stock, only three had directors whose addresses were out-of-state. Only three had three or more family names on the original board of directors. Of the fifty-three corporations authorized to issue 500,000 dollars of capital stock, only one had one or more directors living in another state. Fifty-three percent had only one family name listed on the original board of directors and none had more than three family names listed. *Id.*

47. BERRY, *supra* note 41.

48. *Id.* at 3.

49. *Id.*

50. *Id.*

the appearance of objectionable out-of-state farm corporations will also increase. This is also true of in-state corporations. Until 1956 only twelve domestic farm corporations had organized within the state.<sup>51</sup> One primary reason for the increased interest in farm corporations was probably the passage in 1958 of Subchapter S of the Internal Revenue Code.<sup>52</sup> Beginning in 1960, an average of twenty-four domestic farm corporations were organized each year through 1967.<sup>53</sup> All available statistics seem to indicate that the trend toward farm incorporation is continuing unabated.

Various other reasons have been advanced to explain this increased interest in the corporate form of ownership for the individual family farm. The most often mentioned advantages of selecting the corporate form are limited liability,<sup>54</sup> tax benefits,<sup>55</sup> flexibility in financial expansion<sup>56</sup> and estate planning.<sup>57</sup> Fourteen of fifteen farm incorporators questioned in one South Dakota survey indicated that they believed a major advantage of incorporating a farm is that it helps keep the farm in the family by making estate planning easier.<sup>58</sup> Few, however, felt that incorporation had made credit easier to obtain. One banker was quoted in the survey as stating, "We look at a farm or ranch corporation the same way we look at a small private or family corporation on Main Street. We look to see who and what is behind the corporation."<sup>59</sup> An additional advantage of incorporating in South Dakota is that the state currently has no corporate income tax. This may be transmuted into a disadvantage, however, if the legislature should enact a corporate income tax but not a personal income tax.

### *Legal Restraints on Corporate Farming*

Restrictions on the corporate ownership of agricultural land date back to the depression years of the 1930's. The most notable

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51. Berry, *supra* note 46.

52. INT. REV. CODE OF 1954, §§ 1371-79. Subchapter S allows qualified small corporations to avoid double taxation by electing to be taxed much like a partnership. A farm corporation, qualifying under Subchapter S, would not be taxed as a corporate entity; the only tax would be on the dividends paid to shareholders.

53. Berry, *supra* note 46.

54. Note, *Incorporating the Farm Business: Part I*, 43 MINN. L. REV. 305, 308-17 (1958); Comment, *Considerations When Incorporating the Family Farm*, 39 NEB. L. REV. 547-50 (1960).

55. Abner, *Corporate Farming and the Money Tree*, 4 GA. BAR JOUR. 335 (1968). Shoemaker, *Incorporation of Family Agricultural Businesses*, 30 ROCKY MT. L. REV. 401-15 (1958); Note, *Incorporating the Farm Business Part II: Tax Considerations*, 43 MINN. L. REV. 782 (1959); Comment, *Considerations When Incorporating the Family Farm*, 39 NEB. L. REV. 547, 560-74 (1960); Seminar, *Family Farm Corporations*, 1960 WIS. L. REV. 555, 573-601 [hereinafter cited as Seminar].

56. Seminar, *supra* note 55, at 566-68.

57. Hall, *Agricultural Corporations: Their Utility and Legality*, 17 OKLA. L. REV. 389, 392-94 (1964); Harl, *Considerations in Incorporating Farm Businesses*, 18 U. FLA. L. REV. 221, 224-30 (1965); Note, *Incorporating the Farm Business: Part I*, 43 MINN. L. REV. 305, 319-20 (1958).

58. BERRY, *supra* note 41, at 6.

59. *Id.* at 4.

and sweeping of all state anticorporate farm legislation is that of North Dakota which prohibits any corporation except a farmer owned cooperative from engaging in farm operations.<sup>60</sup> The North Dakota ban on corporate farming has had a long and stormy history<sup>61</sup> that eventually resulted in a test of its constitutionality in the United States Supreme Court. In *Asbury Hospital v. Cass County*,<sup>62</sup> the Supreme Court upheld the North Dakota law against attack on fourteenth amendment grounds. The Court found that the escheat provisions of the Act did not violate the due process clause, nor did the exception created for farm cooperatives run counter to the equal protection clause of the fourteenth amendment.<sup>63</sup>

With the constitutional issues resolved in favor of the state's right to regulate farm corporations, corporate farming legislation was eventually enacted in Minnesota,<sup>64</sup> Wisconsin<sup>65</sup> and South Dakota.<sup>66</sup> The corporate farming laws in these three states are substantially the same. None completely bans farm corporations, nor does any law require the escheat of existing corporate holdings of agricultural land acquired before the passage of the present law.<sup>67</sup> The legislation in each state was drafted so as to distinguish between those farm corporations whose size and market impact threaten the economic well-being of the family farmer and rural communities, and those farm corporations composed of family members who desire to obtain the various tax, estate planning and limited liability advantages of corporate organization.

#### THE FAMILY FARM ACT OF 1974

The South Dakota Legislature first began to seriously consider corporate farming legislation in 1968.<sup>68</sup> Although the bill then introduced did not pass, the 1968 legislature authorized the Legislative Research Council to investigate the effect such an act would have on corporate agriculture in the state. Corporate farming legislation was finally passed in the 1974 legislative session as the Family Farm Act of 1974.<sup>69</sup>

60. N.D. CENT. CODE § 10-06-01, 04 (1960).

61. 1968 *Hearings*, *supra* note 5, at 213-15; Note, *An Analysis of House Bill 782: The Latest Attempt to Repeal North Dakota's Ban on Corporate Farming*, 44 N.D.L. REV. 255-56 (1968) [hereinafter cited as *Corporate Farming Ban Repeal*].

62. 326 U.S. 207 (1945), *aff'g* 73 N.D. 469, 16 N.W.2d 523 (1944).

63. For a discussion of the constitutional questions involved in restricting farm corporations, see Comment, *Proposed Anticorporate Farm Legislation*, 1972 WIS. L. REV. 1189, 1211-13.

64. MINN. STAT. ANN. § 500.24 (Supp. 1974).

65. WIS. STAT. ANN. § 182.001 (Supp. 1974).

66. S.D. COMPILED LAWS ANN. §§ 47-9A-1 to -23 (Supp. 1974).

67. MINN. STAT. ANN. § 500.24(2)(c) (Supp. 1974); S.D. COMPILED LAWS ANN. § 47-9A-5 (Supp. 1974); WIS. STAT. ANN. § 182.001(2)(c)(1) (Supp. 1974).

68. S.B. No. 92, 43d Sess. S.D. Legislature (1968), *reprinted in* 1968 *Hearings*, *supra* note 5, at 40-41.

69. S.D. COMPILED LAWS ANN. §§ 47-9A-1 to -23 (Supp. 1974).

The intent of the legislature in restricting farm corporations is clearly stated in the Act's first section.<sup>70</sup> The law was directed toward prohibiting the large conglomerate farm from operating within the state. The explicit policy statement contained in the Act's initial provision<sup>71</sup> is significant because it will aid interpretation of the Act should it be tested in court. The heart of the Family Farm Act is a blanket prohibition against any corporation engaging in farming or owning farm land.<sup>72</sup> It is followed by twelve sections that carve out exceptions to the total exclusion provision.<sup>73</sup> This comment will discuss the seven most important exceptions to determine the extent of protection given the family farmer and the people of the state from objectionable farm corporations. The comment will separately discuss those exclusions which are necessary and reasonable exceptions to the Act, such as the family farm corporation, and those exceptions which may provide objectionable farm corporations with a means of evading the Act's prohibitions through the use of the authorized small farm corporation provision or by way of livestock feeding or noncorporate organization.

### *Reasonable Exceptions to the Family Farm Act*

#### *A. The Family Farm Corporation*

The most vital exception created by the legislature permitted the formation of what was termed the "family farm corporation."<sup>74</sup> The legislature recognized that the corporate form per se was not a threat to the family farm. In fact, the distinct advantages available through the use of the corporate form can be utilized to advance the family farm concept. Corporate stock can provide the ideal means for accomplishing an orderly transfer of farm ownership between generations without disrupting the farm business. By leaving voting shares of stock to on-farm children and nonvoting shares to off-farm children, parents can be assured of an equal division of their farm assets as well as the continuation of the farm

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70. *Id.* § 47-9A-1 contains the following language: "The Legislature of the state of South Dakota recognizes the importance of the family farm to the economic and moral stability of the state, and the Legislature recognizes that the existence of the family farm is threatened by conglomerates in farming."

71. *Id.*

72. S.D. COMPILED LAWS ANN. § 47-9A-3 (Supp. 1974).

73. *Id.* §§ 47-9A-4 to -15.

74. *Id.* § 47-9A-14 reads as follows:

As used in this chapter, unless the context otherwise plainly requires, "family farm corporation" means a corporation founded for the purpose of farming and the ownership of agricultural land in which the majority of the voting stock is held by the majority of the stockholders who are members of a family related to each other within the third degree of kindred, and at least one of whose stockholders is a person residing on or actively operating the farm, and none of whose stockholders are corporations; provided, that a family farm corporation shall not cease to qualify as such hereunder by reason of any devise or bequest of shares of voting stock.

business by family members. Thus section 47-9A-14 attempted to describe by statute the type of farm corporation that should be allowed to thrive and flourish in South Dakota.

In order to qualify as a family farm corporation, the following four conditions must be met:

- (1) The majority of the voting stock outstanding must be held by members of a family related to each other within the third degree;
- (2) The majority of the individual stockholders must be members of a family related within the third degree;
- (3) At least one of the stockholders must reside on or be actively operating the farm;
- (4) None of the stockholders can be corporations.<sup>75</sup>

The first and second conditions pertaining to stock ownership are obviously designed to assure that the ownership of the farm corporation remains in the hands of the farm family. The legislature apparently believed that by requiring the majority of the voting stock to be held by the majority of stockholders related to each other within the third degree, farm corporations would continue to retain their family character. There still remains, however, the possibility of nonfarm interests purchasing and holding the vast majority of nonvoting stock, and thereby providing the investment financing as well as reaping the profits of a family farm corporation. These conditions could also prove troublesome to the bona fide family farmer who wishes to incorporate. The section requires that lineal and collateral relatives owning the majority of the voting stock must be related within the third degree. First cousins would not qualify because they would be related within the fourth degree.<sup>76</sup> Thus two first cousins who farmed adjoining land could not incorporate their farms together and still qualify as a family farm corporation. While the kinship requirement is a useful means of assuring that a farm corporation retains its family character, the third degree limitation itself is quite arbitrary. A farm corporation will still remain a family operation if second cousins or grandnephews are included as majority stockholders. With fewer family members remaining on the farm, it may become increasingly difficult for potential family farm incorporators to meet the strict third degree kinship standard. A modification of the Act to allow an expansion of the degree of kinship requirement past the third degree would grant greater flexibility to the family farmer by allowing him to include more distant relatives as stockholders.

The third provision of section 47-9A-14, which requires one of the stockholders to reside on the farm, is intended to guarantee

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75. *Id.*

76. *Id.* § 29-1-12 (1967).

that ownership and management of the corporation will not become separated. Absentee ownership has long been regarded as one of the prime characteristics of objectionable farm corporations. The residency provision seeks to establish a direct physical connection between the owner and the land by requiring that at least one stockholder actively farm the land or reside on it. Circumstances may arise under which this restriction would also present complications for an authentic family farm corporation. Parents who have retired from active farming and share stock in the family corporation with nonfarming children, for example, may discover they cannot qualify as a family farm corporation if they have moved off their farm and now reside in a nearby town.

The fourth condition placed on a family farm corporation is that none of the shareholders may be corporations. This provision is consistent with the legislature's belief that the existence of family farms is threatened by conglomerates in farming.<sup>77</sup> A prominent feature of conglomerate organization is the existence of a number of separate corporations linked together by a parent corporation which owns the majority of the stock of each subsidiary. By prohibiting corporate shareholders, the family farm corporation will receive protection against pressure to become a part of a huge food processing conglomerate.

The final clause contained in section 47-9A-14 is necessary to avoid unintentional disqualifications which would prove to be a serious hindrance to estate planning. Under this section, once a family farm corporation is validly organized, it will not cease to qualify as a result of a testamentary transfer of voting stock upon the death of any shareholder.

Difficulties may arise, however, when the stock is received by family members through inter vivos transfer or intestate succession rather than by the "devise or bequest" language contained in the final clause of the section. One of the chief advantages of corporate organization for the family farmer is the estate tax savings that can be achieved through a systematic plan of inter vivos gifts of stock.<sup>78</sup> Such an arrangement will be frustrated if the potential donee could cause the corporation to lose its status as a family farm corporation. Section 47-9A-14 may cause additional problems for farm shareholders who die without a will. The section's final clause only prevents disqualification of validly organized family farm corporations through "devise or bequest." A person who receives corporate farm stock through intestate succession could potentially disqualify the corporation. To avoid such possibilities, the Act should be amended to allow inter vivos or intestate trans-

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77. *Id.* § 47-9A-1 (Supp. 1974).

78. Harl, *Public Policy Aspects of Farm Incorporation*, 20 *BUS. LAW.* 933, 939 (1965); Note, *Incorporating the Farm Business: Part I*, 43 *MINN. L. REV.* 305, 318 (1958).

fers of voting stock to donees related within a designated degree of kinship. Such a provision would permit the transfer of stock to family members without jeopardizing the corporation's standing as a family farm corporation.

### B. Banks

In addition to the general exemptions provided for a business qualifying as a family farm corporation or an authorized farm corporation, the Family Farm Act creates specific exceptions for certain corporate organizations engaged in designated agricultural operations. Both banks and trust companies are exempt from the Act's ban on corporate farming and acquisition of farm real estate.<sup>79</sup> The legislation as originally introduced did not contain an exception for banks and trust companies;<sup>80</sup> however, a floor amendment added the provision.<sup>81</sup> This exception is a reasonable one in view of the fact that South Dakota law provides that banks must sell all real property acquired in the ordinary course of business within five years.<sup>82</sup> Thus there presently exists little incentive for banking interests to give much consideration to farming or ranching. Trust companies, as noted below, may present a much more serious problem.<sup>83</sup>

### C. Agricultural Land Acquired as Security

The Family Farm Act does not prevent the acquisition of agricultural land by a corporation through foreclosure of a mortgage, lien, debt or other encumbrance.<sup>84</sup> This section is important to the family farmer because it assures him adequate financing for farm operations. There would be little incentive for financial institutions to make loans to farmers if they could not secure their loans with farm assets. The section also provides that a corporation acquiring land as a result of such legal action must divest itself of the land within ten years. While the land is owned by the corporation, it can be farmed only if leased to a family farmer or an eligible farm corporation.<sup>85</sup> The Act, therefore, would prevent corporate lenders from holding large amounts of agricultural land acquired through foreclosure. It was just such an occurrence that led North Dakota to pass the first state corporate farming legislation during the 1930's.<sup>86</sup>

### D. The Grandfather Clause

The Family Farm Act contains a grandfather clause that ex-

79. S.D. COMPILED LAWS ANN. § 47-9A-4 (Supp. 1974).

80. H.B. No. 852, 49th Sess. S.D. Legislature (1974).

81. S.D. H.R. Jour. 526 (1974).

82. S.D. COMPILED LAWS ANN. § 51-18-5 (Supp. 1974).

83. See text accompanying notes 103-10 *infra*.

84. S.D. COMPILED LAWS ANN. §§ 47-9A-6, 7 (Supp. 1974).

85. *Id.* § 47-9A-7.

86. *Corporate Farming Ban Repeal*, *supra* note 61.

empties from the Act's restrictions all agricultural land owned or leased by a corporation as of July 1, 1974.<sup>87</sup> It also allows existing farm corporations to expand their acreage holdings at a maximum rate of twenty percent in any five year period.<sup>88</sup> The grandfather clause represents a substantial departure from previously introduced corporate farming bills which required a divestiture of all corporate agricultural holdings within a ten year period.<sup>89</sup> The significance of the present provision is largely dependent on the extent and character of corporate holdings in existence in the state as of the effective date of the Act. The legislature quite plausibly concluded that currently existing farm corporations would not adversely affect the family farmer and therefore declined to give the Act a retroactive application.<sup>90</sup>

#### E. *Land Acquired for Nonfarm Use*

A final reasonable exception worthy of comment<sup>91</sup> concerns corporate ownership of agricultural lands necessary for immediate or potential use in a corporation's nonfarm business.<sup>92</sup> The Family Farm Act allows a nonfarm corporation to hold such land but requires that it may only be farmed under a lease to family farms or qualified farm corporations. This section has significance for potential strip mining operations in the northwestern part of the state. A mining company could own ranch land held for future use or land reclaimed from its strip-mining operations because the land acquired is reasonably necessary for a nonfarming purpose. The Family Farm Act would, however, prevent the mining company from ranching the land except under lease to a ranching business eligible under the provisions of the Act.

#### *Evading the Intent of the Family Farm Act Through Other Exceptions*

The various exceptions contained in the Family Farm Act were designed to permit the existence of farm corporations which did not pose a threat to the family farmer. The exceptions discussed below, however, may provide an avenue for significant nonfarm investment that would defeat the intent of the Act.

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87. S.D. COMPILED LAWS ANN. § 47-9A-5 (Supp. 1974).

88. *Id.*

89. S.B. No. 92, § 3, 43d Sess. S.D. Legislature (1968) (introduced by Mr. Kneip), *reprinted in 1968 Hearings, supra* note 5, at 40-41.

90. An interesting though presently unavailable statistic would be the number of farm businesses that chose to incorporate between the passage of the Act in February of 1974 and the effective date of the Act, July 1, 1974.

91. Other exclusions not discussed include: S.D. COMPILED LAWS ANN. § 47-9A-8 (Supp. 1974) (gifts to nonprofit corporations); *id.* § 47-9A-9 (research and experimental farms); *id.* § 47-9A-10 (breeding stock, nurseries, and seed farms).

92. *Id.* § 47-9A-12.



### A. *The Authorized Small Farm Corporation*

Perhaps the most puzzling provision of the Family Farm Act is that which permits the organization of what has been somewhat inaptly termed the "authorized small farm corporation."<sup>93</sup> The section is apparently modeled after the Internal Revenue Code's Subchapter S definition of a small business corporation.<sup>94</sup> An authorized farm corporation can have no more than ten shareholders. Thus the term "small" is more an indication of the number of shareholders than of the size of the corporation.

Besides placing restrictions on the number of stockholders, the section is similar to Subchapter S in providing that an authorized farm corporation can have only one class of stock, that all shareholders must be natural persons, and that the corporation's revenues from rent, royalties, dividends, interest and annuities may not exceed twenty percent of the corporation's gross receipts. Despite these apparent limitations, the authorized farm corporation potentially provides a direct avenue through which nonfarm interests can engage in agricultural production within the state. The section limits the investment or passive income a corporation may earn but does not in any sense restrict corporate income from actual agricultural operations. Thus any ten individuals could form a corporation and purchase an unlimited amount of South Dakota agricultural land as long as no less than eighty percent of the corporation's revenues were derived from their active farming operations. Because no residency or kinship requirements are placed on the shareholders of an authorized farm corporation, there exists a real opportunity for substantial absentee ownership and investment.

Given the clear intent of the legislature to deter the entry of farm corporations controlled by outside interests, the rationale behind the creation of the exception contained in section 47-9A-15 remains obscure. The section does exclude large public corporations which could not meet the ten shareholder maximum from incorporating within the state. It also would prevent large landholding companies from buying up land and renting it back to family farmers. However, such corporations would be just as effectively barred from operation by the language of section 47-9A-14. Conceivably, the authorized farm corporation may be useful to the bona fide family farmer who, for some reason, cannot qualify as a family farm corporation. The price of the provision, however, may be the entry of a great number of objectionable farm corporations.

Moreover, while the requirements contained in the authorized small farm corporation section 47-9A-15 may be meaningful for tax purposes, they have much less relevance as criteria for determin-

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93. *Id.* § 47-9A-15.

94. *Cf.* INT. REV. CODE OF 1954, § 1371(a).

ing the corporations which pose a threat to the family farmer. Most family farms today could probably qualify as Subchapter S corporations, but certainly corporations composed entirely of nonfarm shareholders could just as easily meet the same requirements. The authorized farm corporation can be readily used by large conglomerates to gain a foothold in South Dakota agriculture. Certainly, if a strong enough economic incentive were present, it would be only a minor inconvenience for any conglomerate to arrange for ten of its stockholders or officers to incorporate a farm or ranch in South Dakota for the purpose of supplying raw agricultural products to the conglomerate's food processing and marketing operations.

Because the authorized farm corporation may eventually prove to be a major loophole in the Act, an effort should be made to modify the section to more closely conform to the legislature's intent in passing the Family Farm Act. It should be recognized, however, that the section serves a useful purpose in allowing farm businesses to incorporate without requiring that the majority of the shareholders be related. The vast majority of farm corporations qualifying under this section will undoubtedly be locally-owned and operated and not attain a size that would threaten the family farmer.

One means of minimizing the possibility that objectionable farm corporations could also qualify under the section would be to impose some form of residency requirement on the shareholders of an authorized small farm corporation. Another possible improvement would be to require that at least one of the shareholders be actively engaged in farming. Such conditions would establish some physical connection between the shareholders and the land and diminish the potential for absentee ownership of farm land. Perhaps the most feasible means of insuring that undesirable corporations do not qualify under the section is to impose a capital limitation on authorized small farm corporations. The permissible size of a corporation would be measured by the amount of capital invested in the corporation rather than by the number of shareholders. Such a method is currently used to define a small business corporation in section 1244 of the Internal Revenue Code.<sup>95</sup>

### B. *Livestock Feeding*

Another floor amendment to the original legislation<sup>96</sup> created an exception for corporations which hold agricultural lands solely for the purpose of feeding livestock.<sup>97</sup> Although both the Minnesota<sup>98</sup> and Wisconsin<sup>99</sup> corporate farming acts include many of the

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95. *Id.* § 1244(c) (2).

96. S.D. H.R. Jour. 526 (1974).

97. S.D. COMPILED LAWS ANN. § 47-9A-11 (Supp. 1974).

98. MINN. STAT. ANN. § 500.24 (Supp. 1974).

99. WIS. STAT. ANN. § 182.001 (Supp. 1974).

same exceptions contained in the South Dakota law, neither provides a comparable exemption for corporate livestock feeders. Legislative acceptance of large-scale cattle feeding operations clearly cannot be reconciled with the statutorily expressed intention to restrict conglomerates in farming. Data from the major cattle feeding areas of the nation shows a rapid increase in the number and size of cattle feeding operations.<sup>100</sup> Publicly owned and vertically integrated cattle feeding operations can achieve economies of scale through volume buying and selling with which the family farmer cannot hope to compete. Additionally, the livestock exception can arguably be read as authorizing the utilization of surrounding farm land to raise the necessary feed grains used in the livestock feeding operation. Thus in a critical area of agriculture where the average family farmer is most vulnerable to nonfarm competition, the Family Farm Act fails to provide even the slightest degree of protection. Because livestock feeding can still be carried on by family farm corporations or authorized small farm corporations, the Act should not be unnecessarily weakened by this total exemption for livestock feeders.

### C. *Noncorporate Methods of Farm Investment*

The restrictions contained in the Family Farm Act are applicable only to those farm businesses organized as corporations. The Act does not in any way inhibit the business activities of farming concerns operating under other business forms. The undesirable characteristics associated with the objectionable farm corporation, however, may be equally present in other farm business organizations. The farm business conducted as a sole proprietorship or partnership may have considerable size, be owned by absentees and employ hired labor to the same extent as would an objectionable farm corporation.

A nonfarm individual who wishes to invest in South Dakota agriculture may choose to use the limited partnership form of business association.<sup>101</sup> The limited partner is much like a shareholder in a corporation. He may freely invest without fear of becoming personally liable for the debts of the partnership. The limited partner, however, may not take an active role in management affairs and still retain his status as a limited partner.<sup>102</sup>

Probably the most attractive form of business organization

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100. Sundquist, *Scale Economies and Management Requirements, in SIZE, STRUCTURE AND FUTURE OF FARMS* 86 (A. Ball & E. Heady eds. 1972). The percentage of fed cattle marketed from feedlots of over 1,000 head capacity increased from about thirty-nine percent of the total number of cattle fed in 1964 to forty-seven percent in 1968. In the same period, the percentage of cattle marketed from feedlots with 8,000 head capacity or more increased from 19.3 percent to 26.9 percent.

101. S.D. COMPILED LAWS ANN. § 48-6-1 (1967).

102. *Id.* § 48-6-10.

which would escape the restraints of the Family Farm Act<sup>103</sup> and yet afford most of the advantages of corporate operation would be the business trust.<sup>104</sup> The original development of the unincorporated business trust suggests its present usefulness as a vehicle for avoiding the Family Farm Act. The organization originated in Massachusetts between 1910 and 1925 as a means of avoiding that state's restrictions on corporate ownership of real estate.<sup>105</sup> Legislation introduced in North Dakota to authorize the use of the common law trust was at least in part an attempt to skirt that state's ban on corporate farming.<sup>106</sup> The business trust is created through a declaration of trust by those wishing to contribute capital to the business. Transferable certificates of trust, similar to shares of stock, are issued to each investor.<sup>107</sup> A governing board of trustees is elected to manage the association under the terms of the trust agreement.<sup>108</sup> The liability of the trustees is the same as that of the officers of a corporation, and the liability of the certificate holders of the business trust is limited to the same extent as the liability of shareholders in a corporation.<sup>109</sup> Profits are divided in proportion to the beneficiaries' share in the trust.<sup>110</sup> The operation of the common law trust so closely resembles the more familiar corporate form of organization that nonfarm interests may find it to be a useful means through which a large number of individuals can invest in South Dakota agriculture.

### *Enforcement of the Family Farm Act*

The effectiveness of the Family Farm Act in deterring objectionable farm corporations from operating within the state depends in large part on the willingness of state officials to enforce it. Primary enforcement responsibility lies with the Attorney General who has the authority to seek an order in circuit court declaring a corporation in violation of the Act.<sup>111</sup> Thereafter, the corporation has a period of five years in which to conform its operations to the Act or divest itself of its agricultural holdings.<sup>112</sup> The Act does not impose a monetary penalty for noncompliance.<sup>113</sup>

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103. *Id.* § 47-9A-4 (Supp. 1974) (trust companies exempt from the Family Farm Act).

104. *Id.* § 47-14-1 (1967). It is also known as the common law trust or Massachusetts trust.

105. *Goldwater v. Oltman*, 210 Cal. 408, 415, 292 P. 624, 627 (1930); H. HENN, *HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* § 58 (2d ed. 1970) [hereinafter cited as HENN].

106. 1968 *Hearings*, *supra* note 5, at 214.

107. HENN, *supra* note 105, § 59.

108. *Id.* § 61.

109. S.D. COMPILED LAWS ANN. § 47-14-10 (1967).

110. HENN, *supra* note 105, § 62.

111. S.D. COMPILED LAWS ANN. § 47-9A-21 (Supp. 1974).

112. *Id.* § 47-9A-22.

113. *But see* WIS. STAT. ANN. § 182.001(4) (Supp. 1974) which provides that any corporation violating the corporate farming laws shall forfeit not more than \$1,000 for each violation. Each day of violation constitutes a separate offense.

Given the crucial role effective enforcement is likely to play in the success of the Act, attention should be given to the enforcement provisions of the Oklahoma corporate farming law.<sup>114</sup> The Oklahoma Act provides for local citizen enforcement by entitling any resident of the county in which a corporation in violation of the law is situated to bring an action for divestment. Additionally, if the action is successful, costs are assessed against the corporation and the plaintiff is allowed attorney's fees. Such an enforcement procedure allows those individuals most directly affected by a corporation's illegal farming activities to act as "private attorneys general" and gain an immediate and inexpensive means of relief.

### *Alternative Legislative Approaches*

A wide variety of legal restraints have been proposed to control the corporate entrance into agriculture. The South Dakota Family Farm Act, as well as the corporate farming legislation in Minnesota<sup>115</sup> and Wisconsin,<sup>116</sup> adopted a prospective approach whereby, in the future, corporations seeking to engage in agricultural production must qualify under the Act's various exceptions. The exceptions represent an effort, however imperfect, to accomplish the difficult task of distinguishing between essentially family farm corporations and industrialized, nonfamily corporations.

Recognizing that large size is perhaps the single most notable characteristic of objectionable farm corporations, some states have set an acreage limitation on the size of farm corporations.<sup>117</sup> Such statutes have the definite advantage of simplicity in application. The rationale behind these statutes is that by setting a statutory limit on the amount of farm land that can be operated by a corporation, large-scale, industrialized corporations will be unable to reach a size large enough to economically operate. Obviously, any such legislation must take into account variations in farming methods within a single state. Size limitations in the ranch land of western South Dakota must not be as restrictive as those in the southeastern cornbelt. One method of setting size limitations that has been suggested involves imposing a separate acreage limitation for each county based on the average farm or ranch size within that county.<sup>118</sup>

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114. OKLA. STAT. ANN. tit. 18, § 953(B) (1971).

115. MINN. STAT. ANN. § 500.24 (Supp. 1974).

116. WIS. STAT. ANN. § 182.001 (Supp. 1974).

117. Kansas presently limits the size of farm corporations to 5,000 acres. KAN. STAT. ANN. § 17-5901 (1974). Mississippi had a provision which limited the acreage held by corporations to 12,500 acres. MISS. CODE ANN. § 5329 (1942), repealed, ch. 235, § 149, Miss. LAWS (1962). Prior to the passage of Minnesota's corporate farming act, no corporation engaged in farming could acquire more than 5,000 acres of land, MINN. STAT. ANN. § 500.22(3) (1947).

118. *Corporate Farming Ban Repeal*, *supra* note 61, at 265.

Other proposed state<sup>119</sup> and federal<sup>120</sup> legislation has sought to limit corporate farming activities by prohibiting any business association having nonfarm business assets of 3,000,000 dollars or more from engaging either directly or indirectly in agricultural production. Such legislation is directed toward restricting the vertically integrated operation of farm conglomerates.<sup>121</sup> A capital limitation would prevent large corporations involved in processing, wholesaling and retailing of food products from expanding their operations to a production level which would be in direct competition with the family farmer.

A final direct approach is the nearly complete prohibition of all corporate farming which, despite repeated attempts to repeal, remains the law in North Dakota today.<sup>122</sup> While the North Dakota law undoubtedly succeeds in keeping out all undesirable farm corporations, it also prevents the genuine family farmer from incorporating. Inasmuch as corporate organization may enable the family farmer to experience significant tax, estate planning and other economic advantages, there remains little justification for such drastic legislation.

Farming by large conglomerates may be indirectly restricted through tax reform. Congressional revision of the federal tax laws to eliminate tax loss farming may do more to curb nonfarm investment in agriculture than any form of corporate farming legislation enacted at the state level. One incentive for conglomerates to enter agriculture results from the substantial tax savings gained by deducting farm losses from other income.<sup>123</sup> The gains the conglomerate realizes on its processing and marketing operations are offset by losses it willingly sustains in agricultural production.<sup>124</sup> Because the ordinary family farmer is engaged exclusively in agriculture, he has only farm income against which to offset farm losses.<sup>125</sup> Conglomerates would be reluctant to expand their operations to the farm production level if such action would result in unfavorable tax treatment.

### *Public Policy Questions*

The underlying assumption upon which the Family Farm Act is founded is that the family farm is a social institution worth pre-

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119. H.B. No. 132, 43d Sess. Mont. Leg. (1973), reprinted in Comment, *The Family: How Are You Going To Keep Them Down on the Farm*, 35 MONT. L. REV. 88, 96-98 [hereinafter cited as *The Family*].

120. S. 1458, 94th Cong., 1st Sess. (1975); S. 950, 93d Cong., 2d Sess. (1973); S. 2898, 92d Cong., 1st Sess. (1971); see Abourezk, *Agriculture, Antitrust, and Agribusiness: A Proposal for Federal Action*, 20 S.D.L. REV. 499 (1975).

121. *The Family*, supra note 119, at 99.

122. N.D. CENT. CODE § 10-06-01, 04 (1960).

123. 1972 Hearings, pt. 3, supra note 18, at 4104.

124. INT. REV. CODE OF 1954, §§ 61, 63, 175, 180, 182.

125. For a general discussion of farm tax shelters and proposals for reform, see Allington, *Farming as a Tax Shelter*, 14 S.D.L. REV. 181 (1969); Davenport, *Farm Losses Under the Tax Reform Act of 1969: Keepin' 'Em Happy Down on the Farm*, 12 B.C. IND. & COM. L. REV. 319 (1971).

servicing. Rarely has this assumption been seriously challenged. There may come a time, however, when the policy reasons behind the Act will be called into question. Is the family farm the most productive and efficient means of agricultural production? Current studies of size in farm production reveal that in most situations, all of the economies of size can be achieved by modern and fully mechanized one-man or two-man farms.<sup>126</sup> If the family farm is currently an economically efficient production unit, will it continue to be so in the future? In a period of inflation and rising food prices will the American consumer tolerate the protection of the family farmer if future corporate enterprises can mass produce a cheaper product? Faced with a worldwide food shortage will there remain any justification for legislation sheltering the family farm if other economic units can increase production?

The answers to these policy questions will require legislative consideration of the many social and economic consequences involved. State legislatures will be called upon to balance the need for further legal restraints on objectionable farm corporations against the potential such restrictions would have for unnecessarily complicating the business plans of genuine family farmers. Undoubtedly, some changes will and should be made. One obvious strength of the Act is that it requires a detailed report of every corporation engaged in farming within the state.<sup>127</sup> Such information will provide the data upon which future amendments can be based.

### CONCLUSION

In response to what state lawmakers believed to be a direct threat to the state's largest and most vital industry, the South Dakota legislature passed the Family Farm Act of 1974. Since the early 1930's the rural population of the state has experienced a steady decline. Fears were expressed that industrialized farms prevalent in other areas of the nation would soon extend into the state and would transform the South Dakota farmer from an independent small businessman to a hired laborer. Others forecast a corporate farming invasion which would revolutionize the state's agriculture and would bring with it social and economic changes that would relegate the family farmer to a place in history alongside the threshing machine and horse-drawn planter.

Despite such fears, it does not appear that the existence of corporate farms in the state has had any marked effect on rural life. Only recently have South Dakota farmers shown much interest in

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126. J. MADDEN, *ECONOMIES OF SIZE IN FARMING* (United States Dep't of Agriculture, Agricultural Economics Report No. 107, 1967), reprinted in *1972 Hearings*, pt. 3, *supra* note 18, at 3743.

127. S.D. COMPILED LAWS ANN. § 47-9A-16 (Supp. 1974).

the corporate form of organization. Thus the corporate farming Act approved by the legislature is prospective in outlook. It seeks to preserve the present structure of South Dakota agriculture from irreparable alteration by the corporate conglomerate.

The Family Farm Act is an attempt to prohibit the operations of objectionable farm corporations while still leaving the family farmer the option to incorporate the family farm if he so desires. In certain circumstances, however, the Act may unduly restrict the family farmer and frustrate the business plans of a farm organization which poses no threat to the family farm concept. In other respects, the Act may prove to be an ineffective barrier to the entry of nonfarm investment. If in the coming years there exists the opportunity to reap huge profits in agriculture, there is little reason to believe the Family Farm Act will prove to be more than a minor hindrance to determined investors. Opportunities for outside investment still remain despite the Act, through conglomerate control of authorized small farm corporations, through livestock feeding and through organization in noncorporate forms. Future legislation should be aimed at eliminating these most obvious shortcomings.

As yet, it is too early to measure the effectiveness of the Family Farm Act. One can only speculate on its ultimate impact on South Dakota agriculture. Nevertheless, one forecast can be safely made. Those who view the law as the savior of the family farmer are certain to be disappointed.

CURTIS S. JENSEN