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No Mere Yeoman: Incorporating the Family Farm – Consideration and Consequences

by

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No Mere Yeoman: Incorporating the Family Farm—Considerations and Consequences

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I. INTRODUCTION

"If God gave me the choice of the whole planet or my little farm, I should certainly take my farm." Ralph Waldo Emerson.1

Farmers have been romanticized as "the founders of human civilization,"2 and "the chosen people of God."3 The corporation, the personification of Big Business, has been condemned as being "[i]ntolerable among the people who desire to be free,"4 and labeled as the "ogre of Wall Street."5 It should not be surprising then, that the juxtaposition of the two — farmer and corporation — has been a stormy union.6 The incidence of corporate farms is not a recent one,7 but it is one that continues to spark public controversy,8 and one becoming an increasingly significant aspect of the American agriculture scene.9

The corporate form10 is only one of several business entities available for the farmer to conduct his business. The most common choice is that of the sole

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3. Id. at 157 (quoting Thomas Jefferson).
4. Id. at 47 (quoting Justice Louis D. Brandeis; testimony before the committee on Interstate Commerce, 1911).
7. Wilbur Aldrich published his Farming Corporations in 1892. Harl, supra note 5, at 940 n.15.
8. The voters of the state of Nebraska approved a constitutional amendment restricting farm corporations in 1982. See infra notes 213-18 and accompanying text; see generally discussion infra at notes 178-218 and accompanying text.
9. See infra notes 40-58 and accompanying text.
propriestorship.11 Other choices generally listed12 include the partnership,13 limited partnership,14 business trust,15 joint stock company16 and cooperatives.17 This Note will restrict its discussion to the corporate farm entity as it relates to the family farm.18 It is intended as a guide of appropriate considerations for the attorney counseling a client considering farm incorporation.

Despite historically hostile public perception,19 resulting in unparalleled statutory restriction on corporate farming,20 the last two decades have witnessed a tremendous growth in farm incorporation.21 After examining these attitudes

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11. In 1978, for instance, 87.8% of all farms were operated as sole proprietorships. U.S. DEPT. OF COMMERCE, 1978 CENSUS OF AGRICULTURE, VOL. I, PT. 51, CH. I, SUMMARY [hereinafter cited as 1978 CENSUS]. Sole proprietorship includes those farms in which property is held as joint tenants. 2 J. FUERGENSEMEYER & J. WADLEY, AGRICULTURAL LAW 130 (1982).

12. 2 J. FUERGENSEMEYER & J. WADLEY, supra note 11; Comment, Farm Business Units in Kansas, 7 U. KAN. L. REV. 348 (1959).

13. "A partnership is an association of two or more persons to carry on as co-owners a business for profit." KAN. STAT. ANN. § 56-306 (1983); Uniform Partnership Act § 6(1) (1914) is the "widely accepted definition." AM. JUR. 2D Partnership § 4 (1971) of partnerships today. Prior to this definition being settled on, although partnerships were commonly recognized, it was said that "[a] definition of partnership which is at once accurate, comprehensive, and exclusive is extremely difficult." Wade v. Hornaday, 92 Kan. 293, 140 P. 870 (1914) (syllabus). See also Bock, Formalizing the Farm Partnership, 54 NEB. L. REV. 558 (1975).

14. "A limited partnership is a partnership formed by two or more persons under the provisions of [this act], having as members one or more general partners and one or more limited partners. The limited partners as such shall not be bound by the obligation of the partnership." KAN. STAT. ANN. § 56-122 (1983), Uniform Limited Partnership Act § 1 (1916). See also KAN. STAT. ANN. § 56-1a101 (1983) (definition of terms under the Revised ULPA (1976)). Limited partners were unknown at common law, and are a purely statutory creation. State v. Williams, 196 Kan. 274, 282, 411 P.2d 591, 598 (1966).

15. A business trust is an unincorporated business association, also known as "common law trust" or "Massachusetts trust," under which property is managed by trustees for holders of transferable certificates evidencing beneficial interests in the trust estate. See KAN. STAT. ANN. § 17-2028 (1981). A farm business trust would be restricted by KAN. STAT. ANN. § 17-5904 (1981) in Kansas, and may be restricted in many other states as well. See generally infra notes 178-218 and accompanying text. See also Hecht v. Malley, 265 U.S. 144 (1924); N. LATTIN, LATTIN ON CORPORATIONS § 10 (2d ed. 1971); Strasner, Agricultural Corporations in Oklahoma, 16 OKLA. L. REV. 161, 165-67 (1963); Annot., 156 A.L.R. 22 (1945).

16. A joint stock company is "[a]n unincorporated association of individuals for the purpose of carrying on business and making profits, having a capital stock contributed by the members . . . and governed by articles of association . . . ." 46 AM. JUR. 2D Joint Stock Companies § 1 (1969).

Generally, a joint stock company is an organization lying midway between a corporation and a partnership. Id. § 2. They are a common law entity and may operate where not prohibited by law, (Bett's v. Hackathorn, 159 Ark. 621, 252 S.W. 602 (1923), N. LATTIN, supra note 15, at § 9), although Kansas would seem to characterize them as a corporation. KAN. CONST. art. 12, § 6.


18. There seems to be no generally accepted definition of "family farm." This may be because different organizations define "family farm" differently to reflect their different purposes. See WADLEY, Small Farms: The USDA, Rural Communities and Urban Pressures, 21 WASHBURN L.J. 478, 478-84 (1982). Many state statutes restricting farm incorporation (see infra notes 178-218 and accompanying text) carve out exceptions for family farms as defined in the statute. Such definitions are usually based on degree of relationship of the operators. In Kansas, for instance, a family farm would seem to be one owned by "persons related to each other, all of whom have a common ancestor within the third degree of relationship, by blood or by adoption, or the spouses or the stepchildren of any such persons, or persons acting in a fiduciary capacity for persons so related . . . ." KAN. STAT. ANN. § 17-5903((1)(i) (1981). Other statutory definitions are similar. See infra note 178.

19. See infra notes 23-39 and accompanying text.

20. See infra notes 178-218 and accompanying text.

21. See infra notes 42-57 and accompanying text.
and growth, this Note will discuss major advantages to the corporate form of operation, and some disadvantages. Although incorporation is not for everyone, some commentators have begun to recommend it. For a variety of reasons, perhaps even Emerson would find his "little farm" best preserved today as a corporation.

II. THE CORPORATE FARM: REPUTATION AND REALITY

A. Public Perception of Corporate Farming

The mistrust farmers and rural communities have for corporate farms is a predominately Midwest phenomenon that can be traced to the beginning of the century. The Great Depression, which saw a worsening of the farmers' plight, and large amounts of farmlands being foreclosed by financial institutions, intensified this attitude. Strictly speaking, it has not been the corporate form of organization per se that has been mistrusted. More accurately, it is a fear that allowing corporate involvement in agriculture will open the door for big business to dominate the land and the farm economy, and destroy the way of life in rural communities. Family farms, as corporations, are generally accept-

22. Israel, Corporate Farming and the Money Tree, 4 GA. ST. B.J. 335, 345 (1968) (incorporation is a tool for maintaining and increasing the efficiency of the family farm); Comment, The South Dakota Family Farm Act of 1974: Salvation or Frustration for the Family Farmer?, 20 S.D.L. REV. 575, 581 n.38 (1975) (incorporation of the family farm is described as beneficial, even ideal).

23. If state enactment of restrictive legislation regarding farm incorporation is an accurate indicator, it is the middle tier of states which are most alarmed. Most, though not all, of the states with such laws fall in the geographic region between the Great Lakes and the Rocky Mountains, from Canada to Mexico. See infra note 178.

24. In 1918, the New York Times reported:

Some regard the advent of corporate farming with alarm; they fear for the alleged independence of our farmers as a class; they see something ominous in the word "corporation." It is associated with Wall Street, which is held up to the farmer as a place where thieves assemble to divide the spoils.


The seeds of this mistrust may have been planted even earlier, during the late 19th Century, when the land boom occurring in the Midwest was exploited by crooked land companies. This encroachment upon "The Land" by "Business" instilled a fierce protectionism in the settlers to preserve their land. Note, Incorporating the Farm Business: Part I, 43 MINN. L. REV. 305, 324-25 (1958) [hereinafter cited as Note, Incorporating the Farm Business]. This attitude, passed down from father to son, may be partially expressed today in restrictions on corporate ownership of farm land, and partially in restrictions on alien ownership of farm land. See Note, Alien Ownership of Kansas Farmland: Can it be Prohibited?, 20 WASHBURN L.J. 514 (1981).

Fears of big corporations "gobbling" up farm land were not just illusions. One western Kansas corporation, the Wheat Farming Co., expanded from 5,000 acres of land owned in 1927 to 65,000 acres owned in 1931. Harl, supra note 5, at 941 n.25. This directly affected Kansas legislation restricting farm corporations. See infra notes 193-212 and accompanying text.

25. Note, Incorporating the Farm Business, supra note 24, at 325 (the Depression Era was one of two periods in history contributing to the fear of large corporations swallowing up agricultural industry, the other being the 19th century land boom discussed supra, note 24).

26. Comment, supra note 24. "Clearly no one believes that the corporate form itself is responsible for the problems of the small family farm . . . . Rather corporate farms are condemned because it is believed that the 'objectionable' farms are incorporated." Id. at 1205.

27. Harl, supra note 5, at 940.

Countless American farmers in the wheat growing country are agitating against the corporation-owned farm and the chain farm. They see visions of gigantic tractors driving them and their families from the land, crushing the enterprises on which they have spent their best years, converting farms into factories with time clocks and wage slaves.

Id. (quoting Gard, Agriculture's Industrial Revolution, 34 CURRENT HIST. 853 (1931)).

28. Comment, supra note 22, at 577:
able; they differ from their unincorporated neighbors only in structure, not content. They rightfully belong to the protected class, not the aggressor class. It is the conglomerate, as farm corporation, with its vertical integration, absentee ownership and control, hired management and labor, industrialization, large size, and significant nonfarm investment capital, that is fought and feared. This anticorporation attitude is so ingrained in the agrarian mindset that, despite the increasingly commonplace role corporations play in the farm scene and the increasing sophistication of the modern day farmer, the farm corporation continues to be perceived as a threat. Legislators and commentators alike stress that positive action must be taken to prevent dissolution of family farms into large corporations. Ironically, the characteristics feared in corporations may be just as likely to come from limited partner structures, but little has been done to restrict them. Meanwhile, as innocuous family farm corporations continue to proliferate, dispassionate discussion of the topic remains rare.

B. Growth of Corporate Farming

Even as the controversy rages, the total number of corporate farms has been on the increase. In 1969 the census of agriculture reported a total of 21,513

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.

Id. (quoting Ben Radcliffe, President of South Dakota Farmers Union, testifying: 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. 23, 25 (1968)). See also Comment, supra note 24, at 1203.

29. Comment, supra note 22, at 581: The farmer 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. Far from threatening rural life, the family farm corporation may well increase the viability of the family owned and operated farm.

Id.

30. See infra notes 178-218 and accompanying text.


32. Id. See also Comment, supra note 24, at 1199.

33. See infra notes 42-57 and accompanying text.

34. In 1982, Nebraskans voted to amend their state constitution to restrict or forbid farm corporations. See infra notes 213-18 and accompanying text. See also supra note 28 (testimony before the South Dakota legislature).

35. See infra notes 140-69 and accompanying text.

36. Comment, supra note 24, at 1214. "Because our present institutional framework favors large industrial farms, to ignore the problem [of statutory regulation of corporate farms in order to preserve the family farm] would in reality be to choose to allow the small family farm to disappear." Id.

37. Limited Partnerships allow a large number of outside investors to pool their collective resources to form a large, industrialized operation that a single family could not construct or compete with. See Harl, supra note 6, at 1255-56. See also Comment, supra note 22, at 592-93.

38. See infra notes 42-57 and accompanying text.

39. See, e.g., Comment, supra note 22, at 577. See also Lake, Constitutionality of "Initiative 300": An Answer, 17 CREIGHTON L. REV. 261, 263 (1984). But cf. Harl, supra note 6, at 1255-58 (a noted agrilaw scholar provides a clear and concise summary of the corporate farm controversy, and a plea for clear thinking on the issue).

40. The 1964 Census of Agriculture did not collect data on farm corporations.
corporate farms, or slightly over 1% of all farm operations. In 1974 there were 28,656 corporate farms, about 1.7% of all farm operations. The 1978 census showed an increase to 51,270 corporate farms, 2.1% of all farms. By 1982, the census reported 59,792 corporate farms, 2.7% of all farm operations. Despite the seemingly small numbers of corporate farms in comparison to the total number of farms, the 1982 census showed the disproportionate role corporate farms play. For instance, although only 2.7% of all farms are corporate farms, they represent 13.7% of all land in farms, and 23.9% of the market value of all agricultural products sold. The average size of a corporate farm is 2129 acres, versus just 330 acres for an individual or family farm. The average value of a corporate farm's land and buildings is $1,520,781 versus $281,014 for an individual or family farm.

Does all this mean, then, that the business corporation with its larger, wealthier farms is replacing the traditional family farm, just as doomsayers have predicted? Not quite. The expanded data reported on corporate farming in the 1982 census showed that of the 59,792 corporate farms reported, 52,652 of them (or 88.1%) were characterized as family farms. Old McDonald hasn't been squeezed out—he's just become McDonald and Sons, Inc!

Although the corporate farm generally tends to be larger and wealthier than the individually owned farm, corporate farming spans the full range in both amount of sales and size of acreage. While 58.7% of all corporate farms

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41. The census of agriculture is conducted approximately every five years by the U.S. Dept of Commerce, and provides exhaustive reporting of all facets of the American agricultural economy, both state-by-state and a summary of the nation as a whole. It is available at Government Document Depositories at most land grant institutions, among other places. Census information for this report was obtained from Kansas State University, Manhattan, Kansas.


43. Id.

44. 1978 CENSUS, supra note 11, at Vol. 1, Pt. 51, Ch. 1, Table 4: Operators, Tenure, Type of Organization, and Characteristics: 1978, 1974, 1969. The 1978 and subsequent Census' considerably expanded reporting on corporate farming. They not only report the number of farm corporations by family-held with 10 or more stockholders, family-held with less than 10 stockholders, other than family-held with 10 or more stockholders, and other than family-held with less than 10 stockholders; but also report all of the size, value, sales, etc., information under these four categories (along with categories for sole proprietorships, partnerships and others). This expansion of corporate data indicates the growing importance of corporate farming in the American agricultural scene.


46. 1982 CENSUS, supra note 45, at Table 45: Summary by Type of Organization.

47. 1982 CENSUS, supra note 45, at Table 45: Summary by Type of Organization.

48. 1982 CENSUS, supra note 45, at Table 45: Summary by Type of Organization.

49. See supra notes 23-39 and accompanying text.

50. 1982 CENSUS, supra note 45, at Table 45: Summary by Type of Organization. Of even more significance is the fact that 50,842 of these farms, 88% of the total, were family corporations with less than 10 stockholders. The total breakdown is: family-held corporations with 10 or more stockholders—1,810 farms representing 12,793,725 acres; family-held with 10 or fewer stockholders—50,842 farms representing 100,664,435 acres; other than family-held with more than 10 stockholders—1,143 farms representing 5,797,237 acres; other than family held with 10 or fewer stockholders—5,997 farms representing 8,471,369 acres. Id.

51. See supra notes 46-48 and accompanying text.

52. A look merely at averages would seem to imply that incorporation is an option only for larger farms. In fact, farms of all sizes and production levels choose the corporate form of operation.
sold over $100,000 of agricultural products in 1982, 12.7% of them sold less than $10,000. And while 31.5% held over 1,000 acres, 24.1% held less than 100.

The picture in Kansas is representative of the nation as a whole. Kansas has 1,876 corporate farms, 2.6% of the total. They represent 3,452,797 acres, 7.4% of all farm acres. The number of corporate farms in Kansas in 1982 is up from the 1,478 reported in 1978, which was double the 678 reported in 1974, which was also double the 328 reported in 1969. Farm corporation data was not collected in 1964.

III. ADVANTAGES OF FARM INCORPORATION

There are a variety of reasons for the recent growth in farm corporations. Various authors have attempted to compile a list of the advantages of incorporating the family farm. Discussion of the more predominate reasons follows.

A. Estate Tax

Because of the unique advantages a corporate farm structure provides to estate planning, estate and inheritance considerations are probably the most

53. 1982 CENSUS, supra note 45, at TABLE 45: SUMMARY BY TYPE OF ORGANIZATION.
54. 1982 CENSUS, supra note 45, at TABLE 45: SUMMARY BY TYPE OF ORGANIZATION.
55. 1982 CENSUS, supra note 45, at VOL. 1, PT. 16, CH. 1, TABLE 45: SUMMARY BY TYPE OF ORGANIZATION.
56. 1982 CENSUS, supra note 45, at VOL. 1, PT. 16, CH. 1, TABLE 45: SUMMARY BY TYPE OF ORGANIZATION.
58. 1974 CENSUS, supra note 42, at VOL. 1, PT. 16, CH. 1, TABLE 14.

One indication of Kansas corporate farming before Census data was collected is available from a 1958 survey of land ownership in Kansas which revealed that "agricultural corporations" owned 1.3% of the land in the state with the average size of a corporate farm being 4,803 acres. HarJ, supra note 6, at 1250 (quoting Land Ownership in the Great Plains States, 1958 STAT. BULL. 261 (Agr. Res. Serv., U.S.D.A., 1960)).

59. See generally 2 J. JUERGENSEMeyer & J. WADLEY, supra note 11, at ch. 30; Kramme, 16 Reasons to Incorporate, SUCCESSFUL FARMING, vol. 70, no. 8, June-July 1972, at 9-12; Randall & DeSantis, Special Problems of Farm Incorporation, 15 GONZ. L. REV. 749 (1980); Comment, Considerations When Incorporating the Family Farm, 39 Neb. L. REV. 547 (1960) [hereinafter cited as Comment, Considerations When Incorporating]. See also Comment, Sole Proprietor's Quandry: Opening the Close Corporations, 54 Neb. L. REV. 527, 527-28 (1975) [hereinafter cited as Comment, Sole Proprietor's Quandry].

predominate reasons a farmer will decide to incorporate. One of the primary questions in considering incorporating the farm business is whether or not the farmer wishes to perpetuate the business. If he does, especially in a family situation, incorporation readily recommends itself. Estate planning purposes have been held proper as the sole justification for incorporating.

Today's farms are much larger and represent much more value than ever before. Although the increase of the federal estate tax exemption in the 1981 Income Tax Reform Act has mitigated a great deal of the problems mentioned in commentary before that date, estate tax concerns are by no means eliminated. The estate tax problem is caused by the escalating value of farms in the last third of this century. A writer in 1975 noted that, since 1942 the average investment per farm had increased almost 1,000% while the then federal estate tax exemption of $60,000 adopted in 1942 had remained unchanged. The predominant element in the increased family farm wealth has been the dramatic inflationary rise in land value. Unlike his grandfather, who was mainly concerned with managing labor, the modern farmer is primarily a manager of capital. And as farm values have increased, the impact of estate tax on these inflated asset values has jeopardized the farm family's ability to preserve capital from one generation to the next.

An estate advantage of incorporation is the ease with which various legal estates can be created through corporate stock. Joint tenancies, tenancies in

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61. A second major reason is income tax considerations. See infra notes 93-149 and accompanying text. See Comment, supra note 22, at 583. See also Comment, Sole Proprietor's Quandry, supra note 59, at 528.

62. Harl, supra note 5, at 943. "[T]he corporation may actually strengthen the family farm by permitting broader family ownership participation, facilitating the transfer of ownership of a complete farming unit from generation to generation and promoting expansion of the farm to an economic size." Id.


64. The Unified Credit Against Estate Tax, 1982 I.R.C. § 2010, effectively exempts estates of up to $400,000 from tax in 1985, and will increase to a $600,000 effective exemption by 1987.

65. A common expression in rural communities is that farmers "live poor and die rich." If today's farmer has an estate tax problem that his great grandfather did not have, it's not merely due to his increased efficiency or size (although those have occurred, see supra notes 40-59 and accompanying text). Rather, it is due to the increased value of his operation. An average sized farmer in 1880 may have had little value in his estate, but an average size farmer today finds that great grandpa's land is suddenly worth a lot (see infra notes 66-69 and accompanying text). Due to this increase in value more than anything else the late 20th century farmer needs to be concerned with estate planning. "The most beneficial service which can be rendered a farmer today is to make him aware that he owns valuable property and should give thought to what will happen to it when he dies." Fleming, An Overall Look at Estate Planning, 45 ILL. L.J. 452 (1957).


67. Kelley, supra note 66. The exemption was substantially increased in 1981, so that by 1987 $600,000 will be exempt from estate taxes. See supra note 62. Further aid to the farm estate tax plan is available through I.R.C. § 2032A (1982) which allows farmland to be valued according to its use, rather than fair market values based on "best and highest use value." It is obvious, though, that the increase in farm value has far outpaced the increase in the exemption, so the thrust of Kelley's argument is still valid.

68. Kelley, supra note 66, at 218. This is especially apparent when it is realized that the average rate of return on agricultural investments during this time has been only three percent. Id.

69. Harl, supra note 5, at 934.

70. Joint tenancies have been defined as: An estate in fee-simple, fee-tail, for life, for years, or at will, arising by purchase or grant to
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common,71 life estates with remaindermen72 and other legal estates common to estate plans are much more readily created out of shares of stock than out of grain, livestock, machinery and other personal property.73 This is especially true when the value of stock is established in the corporate charter or bylaws. Doing so in effect "freezes" the value of each estate created,74 while the wildly fluctuating value of farm products and equipment could wreak havoc with the most carefully constructed estate plan.75 Such freezing of value can also be accomplished by selling stock to potential heirs at a fixed price on an installment contract, or through a binding buy-sell76 option to purchase the stock. The same results can be accomplished through a combination of common and pre-

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71. Tenancies in common have been defined as:
A form of ownership whereby each tenant (i.e., owner) holds an undivided interest in property. Unlike a joint tenancy or a tenancy by the entirety, the interest of a tenant in common does not terminate upon his or her prior death (i.e., there is no right of survivorship). Assume, for example, B and C acquire real estate as equal tenants in common, each having furnished one-half of the purchase price. Upon B's prior death, his one-half interest in the property passes to his estate or heirs.

72. Life estates with remainders have been defined as:
An estate whose duration is limited to the life of the party holding it, or some other person .... A legal arrangement whereby the beneficiary (i.e., the life tenant) is entitled to the income from the property for his or her life. Upon the death of the life tenant, the property will go to the holder of the remainder interest or to the grantor by reversion.

73. Had, supra note 5, at 934. "The ease with which corporate stock may be transferred makes possible the gradual transfer of ownership of the farm business as a whole, rather than transfer of specific assets." Id.

74. A variation on this theme involves issuing preferred stock to the older generation and issuing (or gifting the already issued) common stock to the younger generation. The value of the preferred stock is clearly set and frozen at a fixed sum, or a fixed rate of appreciation. Since the preferred stock value is set, and is given preference to the assets of the corporation over all other interests (though not over debts), the older generation's retirement income is guaranteed. But since all common stock has been transferred to the younger generation, they receive all appreciation in value that the entity might enjoy. This preferred stock issuance creates what is known in federal income tax parlance as "section 306 stock" which may have adverse consequences. See Rev. Rul. 77-455 (application of I.R.C. § 306 excised to a transaction by a family-held corporation). See generally B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS, ch. 10 (1979), for a detailed discussion of "Section 306 stock."

75. See Kelley, supra note 66, at 226-32 for fuller treatment of the creation of legal estates through corporate stock.

76. The effect of buy-sell agreements have been defined thus:
A restrictive buy-sell agreement places limitations upon the disposal of corporate stock in certain events such as death or sale of stock. Under such an agreement, it is usually mandatory or optional for the corporation or remaining stockholders to purchase the
ferred stock, voting and nonvoting stock, and multiple classes of stock or trusts.77

A farmer may have several children whom he wishes to divide his estate among, but only one who wants to continue the farming business. Dividing up the land and machinery among all children can make it difficult if not impossible for the one to continue the farm as a viable business. But when it is stock, rather than assets, that are divided up, continuity is made much easier. Through stock bonus plans78 for the second generation’s work performance on the farm, or through separate classes of voting and nonvoting stock,79 the heir/operator can be assured of control of the corporate entity, while including the other heirs in the estate. All children can be given a share of their parents’ estate, without threatening the survival of the farm business.80

B. Lifetime Transfers

As desirous as farmers may be to see their children succeed them in the farming business, they often may not be willing to further this end through inter vivos transfers of the farm assets,81 even if they fully understand the estate tax advantages such transfers provide and the psychological benefit of including their prospective heir in ownership early on. The reason for this reluctance may be the older farmer’s fear of losing control of the farm, and of seeing a large, efficient operation broken up into smaller parcels.82 Incorporation can be an answer to these concerns. Through a corporate structure, a farmer can reduce the value of his estate83 by inter vivos transfers of value through the gift84 of stock shares.85 Because it is shares, not assets, being given away, the operation

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77. See generally Kelley, supra note 66, at 247-50.
78. A stock bonus is “[A] bonus paid to corporation executives and employees in shares of stock.” WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 2247 (1976). Although not restricted to any type of corporation, some commentators suggest that stock bonuses may have little practical application in farm corporations since they are generally family-held or closely held. See Emry, Tax and Estate Planning Consequences of Incorporation, 2 U.S.F.L. REV. 14, 35 n.99 (1967). Buy-Sell agreements are also discussed at id., 38-39; Lischer, Buy-Sell Agreements for Closely Held Business Interests 44 TEX. B.J. 283 (1981).
80. See, e.g., Randall & DeSantis, supra note 59, at 751.
81. Fleming, supra note 65, at 454.
83. Since 1981 the size of the estate may be less of a problem for family farms. The Unified Credit Against Estate Tax, I.R.C. § 2010 enacted in 1981 provides a credit against estate taxes that in effect exempts estates up to a certain size from any estate tax. For 1985, the size of an estate that can pass tax free is effectively $400,000, and it will increase to $600,000 by 1987. Id. The increase in exemption will cease at that point, however, and as farm values continue to escalate, more farms may again find themselves with a valuation problem, assuming no further congressional action.
84. For optimum tax results, all gifts generally should stay within the tax free provisions of the Present Interest Exclusion, I.R.C. § 2503(b) (1982), allowing a gift of $10,000 per year per donee to pass tax free, or $20,000 if the donor’s spouse elects gift splitting, I.R.C. § 2513 (1982).
85. Valuation of privately held, not actively traded shares of stock may be done by an asset valuation, arrived at by dividing the value of the corporation (assets minus liabilities) by the number of shares and stock issued, or by a capitalized earnings approach. D. HERWITZ, BUSINESS PLANNING 1-6 (Temp. 2d ed. 1984). But this standard valuation technique can be modified to reduce the value of the shares. See infra notes 88-92 and accompanying text.
is not parceled out.\(^8\) As long as the transferor retains over 50% of the stock, he retains total control. Shares of stock are also an easier way to transfer value than through gifts of personal property (a tractor this year, twenty cows the next, ten acres of crop ground the next), even if partition is not a concern. This is especially true when the size of the gift is determined by the Present Interest Exclusion provision of the Internal Revenue Code,\(^8\) which is the maximum amount that can be given away without being subject to a gift tax. That ceiling of $10,000 per donee can be closely approached, without being exceeded, much more readily when it is shares of stock, rather than pieces of property being transferred.

In a close corporation, the concept of "discounting" allows even greater acceleration of asset transfer by tax free gifts. Discounting is based on the premise that "minority stock interests in a close corporation are usually worth much less than the proportionate share of the assets to which they attach."

\(8\) The value of 100% of corporate stock has full asset worth value. The value of less than 33 1/3% of the stock of a close corporation is virtually worthless.\(^8\) Recognizing this, buyers of minority interests of close corporations are hard to find. Therefore, such holdings are discounted below their share of asset value. Such discounting can be substantial,\(^9\) and is commonly accepted by the courts and I.R.S.\(^9\) If a husband and wife owned 50% of the stock, after only a few gifts, their interests would be subject to sizable discounting,\(^9\) thereby increasing the amount of stock that could be transferred tax free each year.

86. Harl, *The Farm and Ranch Corporation—Business Organizational Form of the Future*, 43 NEB. L. REV. 365, at 379 (1963). Incorporation reduces the possibility of a real estate partition through which the donee or legatee of a minority interest in the farm may compel sale. Id.

87. Id. See also I.R.C. § 2513 (1982) for additional advantages available by spouse's electors to "gift split" in effect doubling the size of their gift that can pass tax free, to $20,000 per donee.


89. One example values ownership accordingly:

<table>
<thead>
<tr>
<th>Percentage Ownership</th>
<th>Practical Worth</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>Full ownership</td>
</tr>
<tr>
<td>66 2/3-100</td>
<td>Sell assets</td>
</tr>
<tr>
<td></td>
<td>Authorize liquidation</td>
</tr>
<tr>
<td></td>
<td>Subject to minority shareholder nuisance</td>
</tr>
<tr>
<td>50-66 2/3</td>
<td>Control of management</td>
</tr>
<tr>
<td></td>
<td>Unable to liquidate or sell assets</td>
</tr>
<tr>
<td>50</td>
<td>Deadlock</td>
</tr>
<tr>
<td>33 1/3-50</td>
<td>Can't control operation</td>
</tr>
<tr>
<td></td>
<td>Can block liquidation or asset sale</td>
</tr>
<tr>
<td>0-33 1/3</td>
<td>Worthless</td>
</tr>
</tbody>
</table>


90. See, e.g., Estate of Ethel C. Dooly, 31 T.C.M. (CCH) 814 (1972) where the court valued smaller blocks of stock at approximately 37% of their underlying asset value, and larger blocks at approximately 55%. Neither block represented power sufficient to liquidate the corporation. See also Estate of Pearl Gibbons Reynolds v. Commissioner, 55 T.C. 172 (1970) (first refusal restrictions on sale of stock, not constituting binding sale agreements, will depress the value of a close corporation's stock).


Farmers may choose to incorporate solely for the income tax savings that can be realized through the corporate income tax rate structure. The top tax bracket for individuals is 50%, but for corporations the top tax bracket is only 46%. Especially for higher bracket farmers, significant savings could occur. Farm incorporation used to be recommended for farmers with annual taxable income in excess of $25,000. However, with the declining tax rate schedules for individuals implemented under the 1981 Tax Reform Act, the watershed income level is increasing. Assuming no further tax rate changes, incorporation can still pay off for higher bracket farmers, albeit at a later point than previously.

But the significant tax savings come not in computing tax on the taxable income of a sole proprietor versus a corporation, but in calculating the respective taxable incomes of the two. The farmer in a corporate situation is an employee of his corporate employer. His employer can provide as fringe benefits.

By and large, federal income taxation of a farm corporation differs little from that of any corporation. Corporate tax is an entirely separate and exhaustive area of the law. This Note does not pretend to deal with the ramifications of corporate taxation, to farms or otherwise. For articles dealing specifically with that topic, see Eastwood, The Farm Corporation from an Income Tax Viewpoint: Friend or Foe?, 54 Neb. L. Rev. 443 (1975); Lucas & Wilkonson, Agribusiness: Operating as a Corporation, 6 Tax Advisor 678 (1975).

State income tax is also due in addition to the federal rates. See, e.g., Kan. Stat. Ann. § 79-32,110(a) (1984). The effect of Federal and State income tax is to tax top bracket individuals at 59%.


In 1982, a corporate farm tax liability versus sole proprietor (married filing jointly) could be illustrated thus:

<table>
<thead>
<tr>
<th>Income</th>
<th>Corporate Tax</th>
<th>Sole Proprietor Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$15,000</td>
<td>$2,400</td>
<td>$1,823</td>
</tr>
<tr>
<td>25,000</td>
<td>4,000</td>
<td>4,153</td>
</tr>
<tr>
<td>40,000</td>
<td>6,850</td>
<td>9,195</td>
</tr>
<tr>
<td>60,000</td>
<td>11,750</td>
<td>17,705</td>
</tr>
<tr>
<td>90,000</td>
<td>22,250</td>
<td>32,449</td>
</tr>
</tbody>
</table>

I.R.C. §§ 1, 11 (1982). Obviously, under these schedules, a farmer with a taxable liability under $25,000 would be subject to more tax in corporate form, but beyond that amount, could realize substantial savings.

By 1984, the comparison looked like this:

<table>
<thead>
<tr>
<th>Income</th>
<th>Corporate Tax</th>
<th>Sole Proprietor Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$15,000</td>
<td>$2,400</td>
<td>$1,581</td>
</tr>
<tr>
<td>25,000</td>
<td>4,000</td>
<td>3,565</td>
</tr>
<tr>
<td>40,000</td>
<td>6,850</td>
<td>7,858</td>
</tr>
<tr>
<td>60,000</td>
<td>11,750</td>
<td>15,168</td>
</tr>
<tr>
<td>90,000</td>
<td>22,250</td>
<td>27,900</td>
</tr>
</tbody>
</table>

By 1984, there are still substantial savings to be realized, but they accrue at a higher point than before.

The problem with incorporating solely for income tax reasons is that it's much easier for Congress (and the President) to change the tax structure than it is for a farmer to jump in and out of corporate clothes. A farmer considering incorporation solely for income tax reasons should be cautioned to consider potential tax changes before he adopts a business format that may well survive for decades.

93. 93. By and large, federal income taxation of a farm corporation differs little from that of any corporation. Corporate tax is an entirely separate and exhaustive area of the law. This Note does not pretend to deal with the ramifications of corporate taxation, to farms or otherwise. For articles dealing specifically with that topic, see Eastwood, The Farm Corporation from an Income Tax Viewpoint: Friend or Foe?, 54 Neb. L. Rev. 443 (1975); Lucas & Wilkonson, Agribusiness: Operating as a Corporation, 6 Tax Advisor 678 (1975).


97. In 1982, a corporate farm tax liability versus sole proprietor (married filing jointly) could be illustrated thus:

98. The problem with incorporating solely for income tax reasons is that it's much easier for Congress (and the President) to change the tax structure than it is for a farmer to jump in and out of corporate clothes. A farmer considering incorporation solely for income tax reasons should be cautioned to consider potential tax changes before he adopts a business format that may well survive for decades.

99. 99. See Emry, supra note 76, at 26-27; Hall, supra note 79, at 394; Israel, supra note 22, at 344-45; Randall & DeSantis, supra note 59, at 753-54; Strasner, supra note 15, at 176.
certain personal expenses that are not deductible to the individual but may be deductible to the corporation that pays the expenses for the individual. Among these are health insurance; pension plans; home maintenance, repair and depreciation; and even meals and lodging under the right circumstances. These serve to reduce taxable income by creating deductions where none were allowable before. Paying less tax conserves working capital, and allows faster business value appreciation.

Farm incorporation also provides for two ongoing methods of income allocation to reduce the overall tax burden: allocation to various family members, and allocation to different years. Income paid in salaries is a deductible expense to the business, avoiding the double tax problem of getting money out of the corporation. And by paying a sum of money to not one family member but several, the family's overall tax burden is reduced due to the graduated nature of the income tax rates. This income splitting is available to the unincorporated farmer as well, but the incorporated farmer has one more "splitter" available to him: the business itself. Because the farm corporation is a separate taxable entity, the farmer is not taxed on what the corporation makes, but only on what it pays him. In higher income producing years, by paying out only part of the income as salary (deductible to the corporation) and by leaving part of it in the corporation (not taxable to the farmer), both the farmer's and the corporation's tax brackets can be lowered. This also helps level out farm income

100. Not only personal expenses, but an array of business expenses are also deductible by an incorporated entity. Israel, supra note 22, at 336 (an exhaustive list of expenses deductible by the corporation).

101. I.R.C. § 162 (1982) and accompanying treasury regulations. However, under new regulations issued by the treasury department for calendar year 1985, many such fringe benefits may become taxable to the farmer/employee as imputed income. Taxation of Fringe Benefits, 26 C.F.R. Parts 1, 31, 54 (1985).

102. Not just health insurance is deductible. A medical cost reimbursement plan may be maintained for employees, owners and their families and all expenses incurred be deductible by the corporation. Treas. Reg. § 1.162-10(a) (1984). Disability insurance and group term life insurance are also insurance-type expenses deductible by the corporation generally under I.R.C. § 162 (1982).

103. See Emry, supra note 76, at 27, 32, 38. The tax advantage of employer-provided pension plans is less significant now than it was before the enactment of I.R.C. § 219 (1982), the individual retirement (I.R.A.) provision. Previously, only a corporate or partnership employer could make tax deductible contributions to an individual's retirement program. The sole proprietor was forced to save for retirement with after tax dollars. So incorporation may have been undertaken solely to allow for pretax retirement savings. The I.R.A. provisions allow a sole proprietor to also make pretax savings now, so he need not incorporate to gain this advantage.

104. I.R.C. § 162 (1982). The taxpayer may be required to show that such expenses meet the "ordinary and necessary" test; that they were in fact business expenses. See R.E.L. Finley v. Commissioner, 27 T.C. 413, 425-26 (1956) (to be deductible, expenses must be for a business, for producing income), aff'd on other grounds, 255 F.2d 128 (10th Cir. 1958).

105. If the meals and lodging are furnished for the convenience of the employer, made a condition of employment, and are located on the employment premises, they are not only deductible to the corporation (I.R.C. § 162 (1982)), but are not included as income to the employee (I.R.C. § 119 (1982)).

106. Emry, supra note 76, at 16. See also Wood, supra note 96.

107. Emry, supra note 76, at 24-25.

108. The employee must be paid for work actually performed in a reasonable, businesslike manner. Salaries that the IRS determines are not compensatory, but are excessive, will be disallowed as deductions to the corporation. See, e.g., B.H.W. Anesthesia Found., Inc. v. Commissioner, 72 T.C. 681, 686 (1979) (even if salaries are reasonable, it must be determined whether they are merely a disguised distribution of profits).

109. See infra note 219.

110. See Israel, supra note 22, at 339-40. But see infra note 226.
between good and bad years.

By electing a different fiscal year for the corporation than for the farmer, additional allocation of income benefits can accrue.\(^\text{111}\) This is especially so if the corporation is on a cash basis method. Although farm corporations are generally required to compute taxable income on an accrual basis,\(^\text{112}\) exceptions are made for family corporations\(^\text{113}\) allowing them to elect the cash method. Cash basis reporting for farm income is popular\(^\text{114}\) because of the significant tax savings that it can accrue.\(^\text{115}\) There can be operational dangers if a farmer relies too much on the cash basis, though.\(^\text{116}\)

Other significant tax related advantages to incorporation lie in social security and workers' compensation. The over-65 farm corporation owner can receive income from the farm in the form of dividends or corporate retirement plans without affecting his social security payments.\(^\text{117}\) In case of on-the-job injury or death, workers' compensation payments are available to the farm corporation operator, while the sole proprietor is excluded.\(^\text{118}\)

In addition to ongoing tax savings realized through incorporation, certain savings can be realized at the point of incorporation.\(^\text{119}\) The farmer can avoid recognition of gain on the initial transfer into the corporation of appreciated property with a value in excess of his basis, if he complies with section 351 of the

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111. Different taxable years between the corporation and the farmer allow several planning possibilities. For example, assuming a calendar year farmer, a corporation with a fiscal year ending November 30 could (if on an accrual basis) accrue a salary/bonus expense to the farmer on that date, which would be deductible from its income for Fiscal Year Ending (FYE) November 30, but by delaying payment until January 15, the farmer delays paying tax on the income. Or, a cash basis corporation with a FYE January 30 could make the payment on January 15, recognize it immediately as a deduction on its year and tax return, and still allow the farmer to delay his tax recognition on receipt of the income. Emry, supra note 76, at 20-21. But cf., infra note 147.


113. Id. at § 447(c). This section's definition of family (see supra note 18) is an exceptionally loose one. Subsection (d) defines family broadly enough to include second cousins, and multiple families are allowed joint ownership in subsection (h), with certain restrictions (two families owning at least 65%, or three families owning at least 50%; with the rest of the ownership being held actively or constructively by the corporation's employees).

114. See Miller, Why Farmers Use the Cash Basis, 12 J. TAX'N 122 (1960).

115. Lucas & Wilkonson, supra note 93, at 679. Use of the accrual inventory method for income tax purposes restricts flexibility in regulating taxable income from year to year and transforms capital gain into ordinary income. This undesirable transformation may be illustrated by assuming the sale of a cow or bull raised within the business. Under the cash method the entire proceeds of this sale (assuming the animal was held for at least 24 months) would result in capital gain. Under the accrual method, however, only the difference between the sales price and the inventoried amount would receive capital gain treatment. The inventoried amount would increase ordinary income in current or prior periods.

116. See Israel, supra note 22, at 336 (the privilege of not keeping complete records by using cash method accounting over the accrual method, is not all it may seem to be, since the farm operator must have good records to obtain tax deductions).

117. A sole proprietor or partner continuing to operate the farm may have his social security benefits cut depending on how much earned income he received from the farm operation. 42 U.S.C.S. § 403(b) (1973). Retirement or death benefits are not considered wages affecting benefit payment, though. 42 U.S.C.S. § 409(m) (1973). Dividends from shares of stock are also excluded. 42 U.S.C.S. § 411(a)(2) (1973). See discussion, Emry, supra note 76, at 42, 43; Harl, supra note 86, at 375.

118. See Harl, supra note 86, at 376; Strasner, supra note 15, at 171. See also I.R.C. § 105(c)(d) (1982).

119. Emry, supra note 76, at 24-25.
Internal Revenue Code.\textsuperscript{120} Or, the farmer may have business reasons for wanting to recognize gain at that time.\textsuperscript{121} Planning at the time of incorporation can also yield tax savings later on. If the corporation is financed in part by loans rather than equity contributions from the owner,\textsuperscript{122} later earnings by the corporation can be distributed without the double tax problem—earnings paid as interest are deductible by the corporation as a business expense,\textsuperscript{123} and repayment of the principal is just return of capital, not income (like dividends would be) to the recipient.\textsuperscript{124} Should the enterprise fail completely, the entire loss on the loan would be deductible as a bad business debt by the lender.\textsuperscript{125} Finally, by retaining some assets in his personal name at the time of incorporation, and leasing them to the corporation instead, the farmer can receive earnings from the corporation in the form of rent payments, which are a deductible expense to the corporation.\textsuperscript{126}

When considering incorporation, one potentially advantageous\textsuperscript{127} method that should not be overlooked is the election of S corporation status.\textsuperscript{128} Formerly called subchapter S corporations, their provisions were significantly amended in 1982\textsuperscript{129} to relax the requirements and make S corporation status more attractive.\textsuperscript{130} S corporations have the advantages of standard corporations, except that they are not taxed as such.\textsuperscript{131} Instead, all income or loss, though determined at the corporate level is passed through pro rata to the shareholders for taxation purposes,\textsuperscript{132} much like in a partnership. Only small business corporations can elect S corporation status,\textsuperscript{133} but most corporations which meet stringent state law requirements for farm corporations\textsuperscript{134} could easily qualify for S corporation status.\textsuperscript{135} To elect, all shareholders must file notice of elec-

\begin{enumerate}
\item I.R.C. § 351(a) (1980). See also Randall & DeSantis, supra note 59, at 754-60.
\item 2 J. JUERGENSMEYER & J. WADLEY, supra note 11, at 153.
\item See I.R.C. § 385, where Congress authorized the Secretary of the Treasury to issue treasury regulations to determine whether an interest in a corporation is to be treated as stock or indebtedness. Comprehensive regulations were issued (Treas. Reg. §§ 1.385-1 to -10) and then withdrawn (Treas. Dec. Int. Rev. 7747). To date, no effective regulations have been issued in their place. But the congressional authorization to issue still stands, and the regulations, though withdrawn, may be viewed as indicative of Treasury's thinking on the matter.
\item \textsuperscript{123} See infra note 219.
\item I.R.C. § 163 (1982).
\item \textsuperscript{125} Id. at § 61. Definition of gross income centers on "gain derived"; not return of capital, but gain from capital. Eisner v. Macomber, 252 U.S. 189 (1920).
\item I.R.C. § 166 (1982). See Comment, Considerations when Incorporating, supra note 59, at 548-50, for a fuller discussion of loss deductibility.
\item I.R.C. § 163 (1982).
\item 2 J. JUERGENSMEYER & J. WADLEY, supra note 11, at 130.
\item I.R.C. §§ 1361 to 1379 (1982).
\item The Subchapter S Revision Act of 1982, P.L. 97-354.
\item S. BULLARD, S CORPORATIONS—THE NEW LOOK FOR CLOSELY HELD BUSINESSES 2 (KMG/Main Hurdman 1982).
\item I.R.C. § 1363(a) (1982) exempts S corporations from all federal tax, except in certain, limited circumstances. Thus, the double taxation disadvantage of corporations (see infra note 219) is avoided.
\item Id. at § 1366.
\item Id. at § 1361(b). To qualify the corporation must: a) have 35 or fewer shareholders; b) all shareholders must be individuals, estates or qualified trusts; c) no alien may be a shareholder; and d) only one class of stock may exist. Id.
\item See infra notes 178-218 and accompanying text.
\item Note, Statutory Treatment of The Kansas Close Corporation, 13 WASHBURN L.J. 494, 504 (1974).
\end{enumerate}
tion of S corporation status. Status can be terminated by a shareholder revocation, disqualification, or by failing the passive income test. Upon termination, the S corporation becomes a standard corporation. There is a corrective provision to allow the S corporation to avoid inadvertent termination by correcting its problem, but once terminated, the corporation cannot elect S status again for five years.

The S corporation can be beneficial to farmers for whom the requisite formalities of incorporation may be too demanding, or for new businesses who anticipate beginning years' losses that the owner would like to recognize personally. There are some disadvantages to S status, though. Tax savings through fringe benefits are severely restricted in an S corporation for any owner of over 2% of the stock. The advantages of separate fiscal years may be limited for an S corporation. In case of repeated years of losses, an S corporation may be declared as "not engaged in for profit" and have the deductibility of its excess losses denied.

D. Economic Efficiency

Radford and Martha Dunning of Atlanta, Indiana, saw the tax and estate planning advantages of incorporation. But they didn't stop there. To them, incorporation was also a good business move. Along with their three children and their children's spouses, the Dunning family operates not one but four business structures. The Dunning Farms, Inc. owns all the livestock and grain machinery. It holds the main operation of the farm, and all families participate in it. Most of Radford and Martha's land is held by Radford Dunning Land Corporation. The parents make continual gifts of stock from this corporation to their children as part of an estate plan. Dunning, Smith, and Dunning, Inc., is a corporation owned by the three children formed for their land purchases. Finally, Radford and his oldest son, Rex, have a partnership hog farm operation: D&D Partnership.

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138. Id. at § 1362(d)(1). Revocation takes the affirmative consent of the holders of a majority of the stock.
139. Id. at § 1362(d)(2). The requirements imposed on a business wanting to elect S corporation status (see supra note 134) must be continually maintained; the corporation will be disqualified upon the lapse of any requirement.
140. Id. at §§ 1362(d)(3), 1375. Generally speaking, no more than 25% of corporate receipts for each of three successive years may be from passive income sources such as rents or royalties.
141. Id. at § 1362(f).
142. Id. at § 1362(g).
143. See infra notes 241-43 and accompanying text. The significant relaxing of formalities in an S corporation may be a major factor for a farmer considering incorporation to evaluate.
144. See supra notes 99-106 and accompanying text.
145. I.R.C. § 1372(a) (1982). Taxable income, insofar as fringe benefits are concerned is computed for the S corporation exactly like partnership income is computed: only deductions allowable to an individual are allowed the corporation. For instance, rather than being able to deduct the entire cost of health insurance provided for its employees, an S corporation could only deduct so much of the expenses as exceeded 5% of the corporation's adjusted gross income. I.R.C. § 213(a) (1982).
146. See supra note 111.
147. I.R.C. § 1378(b) (1982). An S corporation is required to elect a fiscal year ending (FYE) December 31, unless it can establish to the satisfaction of the Internal Revenue Service the business purpose of any other FYE.
148. Id. at § 183(a).
149. Id. This section is not applicable to standard corporations.
150. Brunoehler, One Family = 3 corporations and 1 partnership, SUCCESSFUL FARMING, vol. 78, no. 7:22 (May 1980).
151. Id. Dunning Farms, Inc. owns all the livestock and grain machinery. It holds the main operation of the farm, and all families participate in it. Most of Radford and Martha's land is held by Radford Dunning Land Corporation. The parents make continual gifts of stock from this corporation to their children as part of an estate plan. Dunning, Smith, and Dunning, Inc., is a corporation owned by the three children formed for their land purchases. Finally, Radford and his oldest son, Rex, have a partnership hog farm operation: D&D Partnership.
and farmers are finding out: corporations can be a benefit to business management.

Incorporated farms are generally more efficient than unincorporated farms. They can provide a structure for growth and expansion plans, especially when those plans involve additional people as owners or employees. Because a corporation requires increased record keeping, the operator gains a better financial picture of his business, enabling him to be a better manager. And like a limited partnership, a corporation provides a convenient framework for bringing in outside investor capital through equity financing. A farm operator can sell shares of stock to outside investors to finance his business. As long as the operator retains a majority of the stock, he retains total control of the operation. For some, this may provide an attractive alternative to debt financing.

Incorporated farms may also find credit for debt financing easier to obtain, if for no other reason than the increased efficiency and better record keeping that is required by incorporation. Mere conversion from the sole proprietorship to the corporate form won't automatically improve the credit standing of a bad credit risk. But adherence to the requirements of incorporation may serve to improve both credit standing and debt availability. One commentator suggests an additional advantage: lenders' thinking patterns are oriented to dealing with the corporate borrower. Corporate form presents the lenders with more avenues for protecting their investment.

152. This frequently asserted claim seems to be supported by the 1978 CENSUS, supra note 11, at VOL. I, PT. 51, CH. I, TABLE 30: SUMMARY BY TYPE OF ORGANIZATION. The chart for the average value of land and buildings per farm in 1978 lists an average value of $1,099,835 per corporate farm ($1,038,086 per family corporate farm), and just $221,147 per individual farm. But the same chart listed per acre shows the corporate farm has its assets spread proportionately over a larger acreage. Individual farms had an average value per acre of $697, while the corporate farms average value was just $475 ($458 for a family corporation—the lowest of any category). This can be explained in part by economy of scale, and in part by the probability that it is efficient farmers who are more likely to incorporate.

153. Harl, supra note 5, at 943. "[A]s a device for organizing resources of production, the corporation may, with proper planning, lead to . . . larger farm operations." Id.

154. The use of stock bonus plans, and voting/nonvoting shares of stock for successor operators or employees, can allow involvement of several people in one ongoing operation. See generally discussion supra notes 60-92 and accompanying text.

155. Increased record keeping requirements can also be a disadvantage. See infra notes 241-43 and accompanying text.

156. Hall, supra note 79, at 394. "It would seem quite likely that the efficiency of an incorporated farm or ranch would exceed that of its individually owned and operated counterpart because of the detailed record keeping required of corporations . . . ." Id.

157. Bringing in outside investors may be an attractive option to farm families. See Israel, supra note 22, at 338 (farmers may find nonfarming family members or other persons interested in investing in the farm, and corporate farmers can sell their shares of stock for investment purposes without transferring control). "Outsiders" may be restricted from investing in a farming corporation, though. See KAN. STAT. ANN. §§ 17-5903(j), 5904 (1981) (authorized nonfamily farm corporations), and discussion, infra notes 178-218 and accompanying text.

158. See Hall, supra note 79, at 394; Harl, supra note 5, at 947-48.

159. See Comment, supra note 22, at 583 for an argument that incorporation won't make credit any easier to obtain.

160. See Hall, supra note 79, at 394. The argument is that increased record keeping required of corporations will provide farmers with more information to make them better managers and as better managers, better credit risks.


162. A business entity structured as a corporation is more amenable to investment-protecting controls. Corporate resolutions or bylaws can place limits on salaries and other major expenses.
The consolidation of several smaller operating units into one consolidated business can also save the corporate farmer money through the "economy of scale" advantages it gives him. Resources can be pooled to eliminate wasteful duplication; savings in purchases can be realized, both through better buys with larger quantities, and through the decreased need to purchase duplicate items that would be required were the farms still separate business units. Having more products to buy can also earn the corporate farmer premiums unavailable to the smaller operator. And having more produce to sell may open up larger, more attractive markets. Naturally, none of these "economy of scale" advantages apply where an ongoing operation as a sole proprietorship is reconstructed as a corporation. These are advantages based on size, not business format, and the mere reconstruction of the format of a business entity without increasing its size will not incur additional "economy of scale" benefits where none existed before. Only when several small operations are joined together into one corporate unit, or when incorporating provides the structure for rapid expansion that the sole proprietorship didn't lend itself to, will these benefits accrue.

E. Limited Liability

A common reason for incorporating any business entity is the protection against tort and contract liability a corporation provides its owners. In farm corporations, though, this is a rather illusory advantage. A family farm corporation's liability being limited to the amount of the family's investment in the corporation is of little significance if all of the family's assets are in corporate Lenders can be given a place on the board of directors. Corporate income can be restricted in its application. Furthermore, the lender is protected by insuring a business which will not cease to exist upon the death of the key operator. See Strasner, supra note 15, at 170.

One additional advantage corporate borrowers have over individuals is freedom from usury laws. See, e.g., KAN. STAT. ANN. § 17-7105 (1981). Lenders who perceive risks in a loan may not be willing to advance the funds without the greater return on their loan as compensation for the risk. In such circumstances, only corporate borrowers could obtain funds.

163. Comment, supra note 24, at 1193-95. But cf. Comment, supra note 22, at 596. "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." Id. Of course, this size-advantage is the very aspect of corporations that is feared by those concerned about corporations in the farm economy. See Comment, supra note 24, at 1193. See also supra notes 23-39 and accompanying text.

164. Harl, supra note 5, at 943.

165. Comment, supra note 24, at 1193. "[R]esults from improved organization or methods of production . . . are realized through advantages of volume in selling or purchasing." Id.

166. For examples of combining several separate operations together into one unit, see Shoemaker, supra note 82, at 404-05 & n.12.

167. "A leading purpose of such [corporation] statutes and of those who act under them is to interpose a nonconductor, through which in matters of contract it is impossible to see the men behind." Donnell v. Herring-Hall-Marvin Safe Co., 208 U.S. 267, at 273 (1908). "Limited liability in the tort and contract fields is one of the standard reasons given for incorporation." Hall, supra note 79, at 390.

There is no doubt that as a general principle the members are not liable for a corporation's debts; it was so stated in the Digest of Justinian, and has been consistently repeated in modern jurisprudence. The principle is sometimes known as the rule of "limited liability," because it does not relieve corporate members of liability for the amounts they have promised to contribute as the dues of membership or in consideration for shares.

A. CONARD, CORPORATIONS IN PERSPECTIVE § 270 (1976). See also N. LATTIN, supra note 15, at § 11.

168. See Israel, supra note 22, at 339; Randall & DeSantis, supra note 59, at 750; Comment, Sole Proprietor's Quandry, supra note 59, at 552-56.
form. For this advantage to have any meaning, the stockholders must have retained some assets in their own name, distinct from the farm corporation.169 But the more likely incidence is that, when the corporation was formed, all land, livestock, machinery, crops and buildings were transferred into it. Subsequent acquisitions are then almost always made by the corporation, rather than by individuals. In this case, the difference between the corporation having all of its assets levied on, and the corporate owner having all of his assets levied on, is nil.

Even if the farmer has sizable assets separate from the corporation, he may find that they are not automatically protected from the corporation’s creditors. In a tort action, the owner/operator of a closely held corporation170 is likely to be named along with the corporate entity.171 The usual form of protection from tort actions for a farm is insurance,172 be the farm privately held, or organized as a corporation.

Likewise, a farmer’s separate holdings are not necessarily protected in a

169. If all the property involved in a going operation is owned by the corporation . . . the limitation may be somewhat pointless . . . . If the operation itself is all that is incorporated, however, and the land remains in the hands of the original owner or even another corporation, the concept of limited liability may be quite important.

Hall, supra note 79, at 390-91.

But cf. Colten, supra note 31, at 248-49; Strasner, supra note 15, at 171, where the limited liability of a farm corporation is called a “significant non-tax benefit of the corporate farm.” Id. According to a Minnesota survey of twenty-six farm incorporations in 1958, limited liability was the most important reason for incorporating twelve of them, more than any other single reason. Other reasons listed as the primary reason for incorporation were estate settlement, (seven); income tax advantages, (six); and social security purposes, (one). Note, supra note 24, at 308 n.18.

If limited liability is a primary motivational factor for farmers’ decisions to incorporate (assuming for purposes of argument that a 1958 survey of 26 Minnesota farmers is representative of all farmers today), it should not be. Modern commentators seem to emphasize the income tax and estate planning advantages of incorporation, and to de-emphasize, if not dismiss altogether, the assumed advantage of limited liability. See, e.g., Randall & DeSantis, supra note 59, at 750-54. The reason for this shift in emphasis over the last quarter of a century must be more deduced than discovered. In part, it may have to do with the increasingly predominant role taxation has come to play in virtually everything. Income tax is more a factor to be considered now than it may have been twenty-five years ago. It also might result from the practical experience of the liabilities incurred by farm corporations, legal theories and technical safeguards notwithstanding. Doubts about the practicality of this advantage were expressed early on, as well. See, e.g., Shoemaker, supra note 82, at 404.

170. The standard definition of a close corporation was stated in Donahue v. Rodd Electrotype Co., 367 Mass. 578, 586, 328 N.E.2d 505, 511 (1974). “We deem a close corporation to be typified by: (1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation.” Id. See also Brooks v. Willots, 78 F.2d 270, 273 (8th Cir. 1935); Kan. Stat. Ann. § 17-7201 to 7216 (1981) (separate statutory provisions relating to Kansas close corporations); Comment, Close Corporations And The South Dakota Business Corporation Act: Time For Reform?, 23 S.D.L. Rev. 427 (1978); Comment, Sole Proprietor’s Quandry, supra note 59.

171. If not originally named, the owner may be included in the suit personally under the various judicial doctrines of “piercing the corporate veil,” or being the “alter ego” of the corporation. Or, the corporation may be disregarded as a “mere instrumentality” or “dummy.” See generally A. Conard, supra note 167, at §§ 271 to 277; N. Lattin, supra note 15, at §§ 14 to 20.

The mere incidence of sole ownership of the corporation does not de facto result in disregarding the corporate form, however. A. Conard, supra note 167, at § 272. See also United States v. Milwaukee Refrigerator Transit Co., 142 F. 247, at 255 (E.D. Wis. 1905).

[A] corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as [merely] an association of persons.

id.

172. See Hall, supra note 79, at 390; Randall & DeSantis, supra note 59, at 750; Shoemaker, supra note 82, at 404.
contract action. Most lending institutions will require a farmer to individually cosign on any corporate loans, 173 and farmers, more concerned with the success of the enterprise that represents their livelihood than with theoretical notions of limited liability, may be only too willing to cosign. Such action, of course, defeats any protection from liability the corporate farm structure may provide for its investors. Therefore, while a family farm corporation may provide some liability protection, it generally will not. If limited liability were the only reason to undertake incorporating the farm, the farmer would be best advised not to incorporate. 174

IV. DISADVANTAGES OF FARM INCORPORATION

The fact that 97.3%. 175 of all farm operations in the country are not incorporated does not imply that those operations are either too small or too stupid to seize these advantages. Rather, there are very good reasons for not incorporating, and some distinct disadvantages to the corporate form of farming as well. Many farmers may have seriously considered incorporation and decided it was not for them. Others incorporated, decided it was a mistake, 176 and then faced the dilemma of continuing under an awkward form of business enterprise, or of facing the problems of dissolving their corporation. 177 Discussion of the common disadvantages to incorporation follows.

A. State Regulations

Business lawyers and experts on corporate law who are unfamiliar with agricultural regulations might be shocked to discover the type of restrictions placed on farm corporations. A dozen states 178 have enacted statutes specifi-

174. See supra note 169 and accompanying text.
175. See supra note 45 and accompanying text.
177. For the problems of corporate liquidation and dissolution, see infra notes 254-64 and accompanying text.
178. 2 J. JUERGENSMEYER & J. WADLEY, supra note 11, at 154-69. The state, year restrictions were first enacted, and statutes are: IOWA, IOWA CODE ANN. § 172C (West Supp. 1984) (enacted 1975). The stated purpose of the statute is "to preserve free and private enterprise, prevent monopoly, and protect consumers." IOWA CODE ANN. § 172C.2 (West Supp. 1984). The statutes regulate corporations and partnerships but provide several exceptions. Id. at § 172C. Kansas, KAN. STAT. ANN. §§ 17-5902 to -5904 (1981) (enacted 1931). See discussion infra notes 193-212 and accompanying text. Minnesota, MINN. STAT. ANN. § 500.221 subd. 2 (West Supp. 1985) (enacted 1973). The statute restricts corporations, partnerships, trusts, and other business entities from acquiring title, legal or beneficial, to agricultural land unless 80% of the beneficial interest of the ownership is held by citizens or permanent residents of the United States. A few limited exceptions are provided. Id. Missouri, MO. ANN. STAT. §§ 350.010 to .030 (Vernon Supp. 1984) (enacted 1975). No corpo-
ration is allowed to engage in farming, but those already so engaged on September 28, 1975 were grandfathered in. Exceptions are made for encumbrances, family farms, and "authorized" farms among others. Id. Nebraska, NEB. REV. STAT. §§ 76-1501 to -1517 (1981) (enacted 1975). The stated purpose of the statutes is "to nurture the free enterprise system, to provide for the continued existence of the family farm against potential monopolization of the agricultural industry and to protect against alien ownership of Nebraska agricultural land." Id. at § 76-1501 (1981). Despite the broad intent of that purpose statement, the statutes are only a filing requirement for corporations, and some restrictions on trusts. Id. at §§ 76-1501 to -1517. In 1982, a constitutional amendment was voted on to further restrict agricultural lands. See infra notes 213-18 and accompanying text. North Dakota, N.D. CENT. CODE §§ 10-06-01 to -06-15 (1981) (enacted 1932). See discussion infra notes 184-92 and accompanying text. Oklahoma, OKLA. STAT. ANN. tit. 18 §§ 951-56 (West Supp. 1984) (enacted 1971). Foreign farm corporations are prohibited but certain domestic corporations
cally regulating corporate farming in ways no other corporation is regulated. 179 Most statutes place limitations on the size of the corporation, 180 the number of stockholders, 181 form of ownership, 182 limitations on the type of activities they're allowed to engage in 183 or other such limitations.

Two of the earliest states to impose such restrictions were Kansas and North Dakota. 184 Both statutes seem to have been enacted in response to the escalating number of farm foreclosures during the Great Depression. North Dakota's provision, 185 which was approved by the voters in 1932, prohibited any corporation from owning more land than necessary for their business, from engaging in the business of farming or agriculture, and required all corporations holding farmland in violation of the statute to divest themselves of such land within ten years. 186 The statute was interpreted not as a ban to a corporation taking title to farmland, as in a foreclosure action, but as a basis for action requiring divestiture of land held in violation of statute. 187 The statute strictly forbade any farming business being organized as a corporation. In 1967 the North Dakota voters were again presented the issue, this time in the form of a bill allowing certain restricted types of corporate farming. 188 They rejected it by
more than a three-to-one margin. In 1981, without consulting the voters, the North Dakota legislature changed the law to permit incorporation of farms which meet certain requirements. For the first time in a half century, it was possible to have a farm corporation in North Dakota. Still, any type of corporation not specifically included in the statute is prohibited from farming.

Although North Dakota is unique in the length of time they strictly prohibited farm incorporation, the restrictions themselves are not unique. Kansas, which was the first state to enact statutory regulation specifically on farm corporations, virtually barred corporate farming from 1931 to 1965. Prior to 1932, no Kansas statute specifically addressed corporate farming, although the statutes on corporations in general listed "encouragement of agriculture and horticulture" as a purpose for which corporations could be formed. But the statute enacted in 1931 prohibited corporations from engaging in most types of agriculture. In addition, State v. Wheat Farming Co., decided in 1933, held that over thirty years of interpreting "encouragement of agriculture and horticulture" as involving farming for profit did not bar a different interpretation, and ordered corporate farms to divest within a reasonable time.

Kansas farm corporations are currently governed by Kansas Statutes Annotated (K.S.A.) §§ 17-5902 to -5904 adopted in 1981. These statutes prohibit trust or corporate ownership, acquisition, or leasing of agricultural land unless the corporation is one of five excepted types: family farm corporation, authorized farm corporation, family trust, authorized trust or testamentary.
tary trust. Excluded from the statute's coverage are a variety of instances, including creditors' encumbrances, and land held by corporations as is necessary for the operation of a nonfarming business. The latter is in response to State of Kansas v. E.I. Du Pont De Nemours & Co., which was the catalyst for the 1981 change. The prior statute prohibited a corporation from "directly or indirectly engaging in the agricultural or horticultural business . . . ." The present statute more clearly defines what is and is not considered "farming" and sets out a variety of exceptions to the statutory restrictions, including the one that qualifies Du Pont's ownership.

In contrast to recent actions by Kansas and North Dakota relaxing their regulations on farm corporations, Nebraska, in 1982, enacted a constitutional amendment by referendum restricting farm corporations. The amendment restricts both the operation of farms and the ownership of agricultural lands, although a major exception is made for family farm corporations.

202. A family trust is defined as a trust in which the majority of the equitable interest is held by, and the majority of the beneficiaries are, persons related to each other within the third degree (by birth, adoption or marriage) or fiduciaries for such; and in which all of the beneficiaries are natural persons, fiduciaries for family members, or nonprofit corporations. Id. at § 17-5903(1).

203. An authorized trust is defined as a trust with no more than fifteen beneficiaries; all of whom are natural persons or fiduciaries for such, or nonprofit corporations; and which is not exempt from Kansas or federal income tax. Id. at § 17-5903(m).

204. A testamentary trust is defined as a trust created by a will, as defined in the Kansas Probate Code. Id. at § 17-5903(n).

205. Bona fide encumbrances taken for purposes of security for a debt are excluded from the statutory restrictions. Id. at §§ 17-5904(a)(1), (4).

206. Id. at § 17-5904(a)(3).


208. The case deals with the then existing law, KAN. STAT. ANN. § 17-5901(a) (repealed 1981). The statute prohibited all but certain types of corporations (of which Du Pont clearly was not one) from "engag[ing] in . . . agricultural or horticulture business . . . ." Id. The court, aware of the change in the statute then pending in the legislature, sidestepped the issue of whether or not defendant was actively engaged in farming by controlling the production of crops on the land, and accepted defendant's contention that the statute did not specifically prohibit the corporate ownership of agricultural lands. The main purpose of the attorney general's office in bringing this action apparently was to encourage a change in the then existing law, under which the secretary of state annually reported to the attorney general numerous suspected violators, whom it was felt did not warrant prosecution. (Interview with Deputy Attorney General Wayne Hundley at the Kansas Attorney General's Office, April 12, 1984).


211. Id. at § 17-5904(a).

212. Id. at § 17-5904(a)(3).

213. Initiative Petition No. 300, which was approved by the Nebraska voters, amends article XII of the Nebraska Constitution. Its basic prohibition is that: "No corporation or syndicate shall acquire, or otherwise obtain an interest, whether legal, beneficial or otherwise, in any title to real estate used for farming or ranching in this state, or engage in farming or ranching." Brown & Brown, Constitutionality of Nebraska's Initiative Measure Prohibiting Corporate Farming and Ranching, 17 CREIGHTON L. REV. 233, 234 (1984). The complete initiative provision is reprinted, id. at 256-59.

214. The process of constitutional amendment by the initiative process in Nebraska is guaranteed by NEB. CONST. art. III, § 2.


216. Brown & Brown, supra note 213, at 257. See also Colton, supra note 31, at 255.

217. The Omaha Nat'l Bank v. Douglas (No. 372-191 Dist. Ct. of Lancaster County, Neb., filed July 6, 1983). On January 31, 1985, Judge Endacott issued an order in the case substituting Eugene Crump for the named defendant; announcing that Professor James Lake had accepted the court's invitation to participate as amicus curiae (see Lake, supra note 39 for an indication of what his
that the enactment conflicts with provisions of the Nebraska and United States Constitutions and with the National Bank Act.\textsuperscript{218}

B. Income Tax

The primary income tax disadvantage to incorporation is double taxation.\textsuperscript{219} The farm corporation must pay taxes on its profit, and any dividends it pays to its shareholders are again taxable to them. This double taxation may offset the income tax advantages incorporation can bring.\textsuperscript{220} The standard method for avoiding this problem, especially with close corporations, is to avoid dividend payments and pay most of the corporate earnings to the owner/operator in salary, which is a deductible expense to the corporation.\textsuperscript{221} This is not a complete answer, though. During times of high profit, the owner must either take money beyond his reasonable salary through dividends, and endure the double taxation, or leave the profits in the corporation and be potentially subject to the accumulated earnings tax.\textsuperscript{222} In times of low earnings, the opposite problem occurs. Even though the corporation is earning little or no money, the owner/operator is still being paid a salary, and is taxed on that salary. This may be irksome to the farmer who feels he is both losing money and paying income taxes.\textsuperscript{223}

A significant income tax disadvantage to incorporation is the unavailability of capital gains deductions.\textsuperscript{224} Additionally, corporate capital losses are deductible only to the extent of capital gains.\textsuperscript{225} Other tax disadvantages are the potential of an accumulated earnings tax,\textsuperscript{226} and a potential personal holdings company tax.\textsuperscript{227} The aggregate social security taxes may be higher as well, since payments for both employer and employee contribution must be made.\textsuperscript{228} Even some income tax advantages to incorporation may have less favorable aspects.

\textit{amicus curiae} brief will probably say), and ordering parties to submit and exchange simultaneously their initial briefs no later than March 18, 1985, their responses no later than April 2, 1985, and to have the matter ready for the court by April 3, 1985.

\textsuperscript{218} Brown & Brown, \textit{supra} note 213, at 233. \textit{See also} Lake, \textit{supra} note 39.

\textsuperscript{219} The so-called double taxation problem occurs when a corporation pays tax on its profits, then distributes the after tax profits as dividends to its shareholders, to whom the receipt of such dividends is also taxable.

\textsuperscript{220} \textit{See supra} notes 93-127 and accompanying text.

\textsuperscript{221} \textit{I.R.C.} § 162(a) (1982). \textit{But cf.} Harold's Club v. Commissioner, 340 F.2d 861, 867 (9th Cir. 1965) (to the extent that a salary is unreasonable it is not deductible). \textit{See also} Rev. Rul. 59-110, 1959-1 Cum. Bull. 45.

\textsuperscript{222} \textit{See infra} note 226.

\textsuperscript{223} \textit{See Farm Corporation Losses, SUCCESSFUL FARMING, vol. 78, no. 9:7 (Aug. 1980).}

\textsuperscript{224} \textit{I.R.C.} § 1202(a) (1982). \textit{See Emry, supra} note 76, at 44 n.137.

\textsuperscript{225} \textit{I.R.C.} § 1211(a) (1982). Losses from sales or exchange of capital assets are allowed only to the extent of gains from such sales or exchanges.

\textsuperscript{226} \textit{Id.} at § 531. The tax is imposed on corporations, who are improperly accumulating a surplus. The tax is an additional 27 1/2\% of accumulated earnings up to $100,000, and 38 1/2\% thereafter. "Excess accumulation" is excess beyond the reasonable needs of the business, as defined generally \textit{I.R.C.} §§ 531-37 (1982). \textit{See Israel, supra} note 22, at 339-40.

\textsuperscript{227} \textit{I.R.C.} §§ 541-47 (1982).

\textsuperscript{228} \textit{See discussion, Emry, supra} note 76, at 43.

\textsuperscript{229} \textit{See supra} notes 111-16 and accompanying text.

\textsuperscript{230} \textit{I.R.C.} § 1251(b) (1982). The "EDA" is a provision converting potential capital gain into
the application of the "hobby farm" provision\textsuperscript{231} denying loss deductibility, but the Commissioner may achieve the same result by a different route.\textsuperscript{232}

\textbf{C. Economic Implications}

Several nontax economic disadvantages exist for the farm in corporate form. Under state law, they will be subject to a variety of fees for being formed and continuing in existence.\textsuperscript{233} The difficulties in getting earnings out of the corporation\textsuperscript{234} may be especially burdensome in the case of early year losses.\textsuperscript{235} Those difficulties can also be a problem when it comes time to provide for the retirement income of the older generation of an ongoing enterprise.\textsuperscript{236} Some corporation status may be a solution to these earnings distribution problems, but not all corporations can, or want to, qualify.\textsuperscript{237}

Certain protections provided for the farmer as an individual, such as the bankruptcy protections of homestead\textsuperscript{238} and freedom from involuntary bankruptcy,\textsuperscript{239} are available only to individuals, not to corporations or holders of corporate stock. Corporations formerly were restricted in their access to federal loan programs by federal loan and regulation,\textsuperscript{240} and although those restrictions are now all repealed, some state credit agencies may still restrict or look disfavorably on farm corporations.

\textbf{D. Corporate Control}

As a sole proprietor, a farmer can mingle personal and business funds. The same checking account can be used to buy a new tractor or to buy Junior’s

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\textsuperscript{231} I.R.C. § 183(a) (1982). See supra note 148.

\textsuperscript{232} Deductions may be disallowed under I.R.C. § 269 (1982) if the principal purpose of procuring the benefit of a deduction is the evasion of federal income tax. See Borge v. Commissioner, 405 F.2d 673, 677-79 (2d Cir. 1969) (a part-time business setting used for tax avoidance purposes, deductions not allowed).

\textsuperscript{233} See, e.g., KAN. STAT. ANN. §§ 17-7502 (1981) (initial $50 recording fee); 17.7503(c) and 7505(c) (annual franchise tax of $20 to $2,500); and 17-7506 (filing fee for corporate documents). These additional costs may deter some farmers from incorporating. Harl, supra note 5, at 945.

\textsuperscript{234} See supra notes 219-21 and accompanying text. See also supra notes 122-27 and accompanying text.

\textsuperscript{235} Lucas & Wilkerson, supra note 93, at 681.

\textsuperscript{236} Conceptually, the problem of providing income for the older farmer may be a problem with no good solutions. He can have dividends paid on his stock, assuming the corporation has the money, but to do so he must be willing to accept the double tax bite. Payment to him in the form of salaries can only be in an amount commensurate with the services he performs (see supra note 221). Preplanning for passive income avenues from the corporation (see supra notes 122-27 and accompanying text), or for pension plans (see supra note 103) may alleviate this problem, but if not done initially, they probably can’t be done.

\textsuperscript{237} See supra notes 128-49 and accompanying text.

\textsuperscript{238} See KAN. CONST. art. 15, § 9; KAN. STAT. ANN. § 60-2301 (1983).


\textsuperscript{240} Harl, supra note 6, at 1253, n.37-39.
shoes. As a corporation, that laxity is not available.\textsuperscript{241} Not only must separate accounts and separate books be kept for the farmer and for the corporate farm, but one account cannot be used to pay bills properly belonging to the other. Before the corporate farmer pays any bill, he must determine whether it is essentially a personal obligation, or a business one. If the business has plenty of cash on hand at a time when the farmer’s personal account is lean, or vice versa, he cannot simply pay one’s bills with the other, or transfer funds without justification. He must learn to think of himself separately from the farm.\textsuperscript{242} For family corporation owners, it may be difficult to comprehend this separation. Because of the independence they became accustomed to as sole proprietors, because of the personal identity they have with a farming operation that may have been in their family for generations, this unnatural separation of farm and farmer may prove to be an insurmountable obstacle.\textsuperscript{243}

A separate, but significant problem of control exists from the minority stockholder’s position. A partner who is dissatisfied with the partnership can terminate it and recoup his interest.\textsuperscript{244} A stockholder in a publicly held corporation who disagrees with the operation of the corporation has a ready market in which to sell his stock and recoup his interest. But a minority stockholder in a close corporation is in a helpless position. There is no ready market for his shares; in fact, there may be no market at all. He doesn’t have enough votes to affect policy decisions on the board of directors, so he must live with whatever the others may decide. And he has no power to dissolve the corporation.\textsuperscript{245} This lack of power, coupled with the policy of most close corporations to pay few, if any, dividends results in the minority stockholder finding his investment locked in. Instead of a share of land and personal property he would have otherwise had, he has a worthless piece of paper.\textsuperscript{246}

These problems can be mitigated somewhat by advance planning. Through stockholder agreements, high quorum or high voting requirements, or cumulative voting, the minority stockholder may be assured of meaningful representation on the board.\textsuperscript{247} The corporate charter or bylaws can give the minority stockholder a veto power on corporate action,\textsuperscript{248} although this may increase corporate deadlocks. Stock buy out\textsuperscript{249} provisions can also be included in the charter, to provide the minority stockholder with a way to recoup his investment. But absent specific provisions such as these, a minority stockholder may

\textsuperscript{241} Emry, supra note 76, at 45.

\textsuperscript{242} Eastwood, supra note 93, at 530, “Incorporating a business which has traditionally been commanded by a single individual or a select group of individuals involves a nearly total change in business philosophy.” Id.

\textsuperscript{243} Shoemaker, supra note 82, at 402. “Unfortunately, incompatibility problems are difficult to predict prior to incorporation.” Id.


\textsuperscript{245} Note, supra note 136, at 502.

\textsuperscript{246} Shoemaker, supra note 82, at 414.

\textsuperscript{247} Comment, Close Corporations and The South Dakota Business Corporation Act: Time For Reform?, 23 S.D.L. Rev. 427, at 437 (1978) noting that the most common type of shareholder agreement is a voting contract regarding election of directors. Id.

\textsuperscript{248} Id. at 443-44.

\textsuperscript{249} See Lischer, Jr., Buy-Sell Agreements for Closely Held Business Interests, 44 Tex. B.J. 283 (1981).
find himself in a disadvantageous position, especially in the case where the minority stockholder is an off-farm heir subject to the control of a co-heir who is the farm operator. If the majority stockholder/operator chooses to payout all corporate profits in salary, and declare no dividends, the off-farm heir may find their legacy worthless.

V. CORPORATE LIQUIDATION AND DISSOLUTION

"Decisions to embrace the corporate form of organization should be carefully considered, since a corporation, like a lobster pot, is easy to enter, difficult to live in, and virtually impossible to get out."

Despite the potential advantage of incorporation, some farmers may be concerned with the seeming permanence of incorporating their farm. A farm partnership can be easily entered and left, without any serious consequences. But a farmer wishing to dissolve his corporation may find himself faced with unacceptable tax consequences. A farmer in corporate form wishing to liquidate under federal tax law has several options. The easiest way to dispose of the corporation is to sell all the shares of stock in the corporation. This doesn't affect the operation of the farm, but merely transfers ownership and control of it, and is only feasible if a buyer can be found who wants to acquire an ongoing concern. This method of liquidation puts the farmer out of farming, and that may not be what he wanted.

If a buyer of stock as such could not be found, the farm corporation could sell all of its property, and then distribute the proceeds of sale to its shareholders, leaving an empty corporate shell that may be maintained or terminated under state law as the shareholders wish. The tax consequences of a sale/distribution may be prohibitive, though. On sale, the corporation is taxed to the


251. Comment, supra note 247, at 445. In fact, a secure job with the corporation may be the shareholder's only return on his investment, given the usual practice of distributing a high percentage of close corporation earnings in the form of salaries rather than as dividends. Furthermore, the firing of a minority shareholder-employee is a favorite "squeeze-out" tactic and when coupled with deliberate dividend withholding and unmarketable shares it can mean economic disaster to the 'squeezee.'

252. Of course, the minority stockholder position can be an advantageous one in estate planning, when it is the grantor, not heir, as minority stockholder. See supra notes 88-92 and accompanying text.

253. "Liquidation" of a corporation is a federal income tax term, denoting an emptying of assets from the corporation to the shareholders in a distribution or redemption in partial or complete liquidation. "Dissolution" of a corporation is a state law term, denoting an ending of the corporation's legal existence. The two terms should not be confused. A complete liquidation of a corporation without a corporate dissolution is possible, and not unusual. Owners may liquidate the corporation to cease the business activity it's been conducting, but leave the "corporate shell" in existence as a framework for a possible new business venture later on. In either liquidation or dissolution, applicable statutes must be closely studied and carefully complied with.

254. B. BITTKER & J. EUSTICE, supra note 72, at 2-4.

255. See generally Hood, Shors & Trippett, Tax Consequences for Corporate Divisions of the Family Farm Corporation, 4 J. Corp. L. 1 (1978).


extent proceeds of sale exceed its basis, and then the shareholder is taxed again on distribution. Two escape hatches are available to avoid this result, and they are relatively easy to qualify for. But if they are not complied with, the double taxation problem returns with a vengeance: the farm could have practically nothing left after paying all the taxes.

Should the farmer also decide to dissolve his corporation under state law, he may (in Kansas) petition the district court to appoint a trustee or receiver to take charge of corporate property during the dissolution. The trustee or receiver pays the debts of the corporation and distributes the remaining property to shareholders. A corporation is not dissolved until all taxes and fees owed the state are paid, and is considered to continue in existence for three years after dissolution for the purpose of prosecuting and defending suits.

Should a farmer decide to dissolve his corporation, careful planning and individual consultation with the farmer's attorney and accountant are necessary to determine the most favorable course for him. No farmer should undertake incorporating without at least being made aware of the complexities of dissolution, should that need arise. In short, the would-be corporate farmer would do well to remember the lobster, and plan his escape before he enters the structure.

VI. CONCLUSION

Although it still represents a small part of the total farm picture, farm corporations are a growing segment of American agriculture, popular among the larger farms, and certain to be around for some time. Incorporation has many advantages to recommend itself to a farm operation. Predominate among these is the income tax savings potential. Corporate tax rates can be lower than individual rates, but the real savings comes in a corporation's ability to create deductible expenses out of previously nondeductible expenses. The corporate form can also make dividing up a farm operated among farming and nonfarming heirs.

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258. The shareholder is taxed on the distribution either as a dividend, in which case it is taxable as ordinary income to the extent of the corporation's earnings and profits (see I.R.C. §§ 301(c), 316 (1982)); or as a redemption of the shareholder's stock by the corporation, in which case it is taxable as capital gains to the extent proceeds exceed the shareholder's basis in stock (See I.R.C. § 302 (1982)).

259. The Internal Revenue Code provides two "escape hatches" allowing corporate liquidation to be undertaken without double taxation. The most common one is the "12 month liquidation" (I.R.C. § 337 (1982)). This allows the corporation to sell or distribute all of its assets without recognizing any taxable gain at the corporate level. Basic requirements of this section are: formal adoption of plan of liquidation by corporation; complete liquidation of corporation; and completion of plan no later than twelve months after its adoption.

The one month liquidation (I.R.C. § 333 (1982)) provides very favorable tax treatment of the distributions to shareholders providing the corporation has little if any earnings and profit, and little cash, stock and securities. Use of section 333 would be especially helpful in liquidating a new corporation, or an "S Corporation," both of which would have low earnings and profits. For more detailed treatment of corporation liquidations, see B. BITTKER & J. EUSTICE, supra note 72, ch. 11; Lucas & Wilkonson, supra note 93, at 683-84.


261. Id. at § 17-6806.

262. Id. at § 17-6807.

263. Cain, supra note 176.
an easier task, and one less threatening to the viability of the farm as an operation. Incorporation may provide the tools necessary to improve management and efficiency of a farm. It also provides a vehicle for infusing nonfarm investor capital into an operation without threatening the original operator’s control.

This latter potential advantage, and farm incorporation in general, may be restricted by stringent state law requirements. Several states, as recently as the 1970’s, have enacted restrictive statutory requirements on farm incorporation. The apparent motivation for such restrictions has been a desire to “save the family farm” from “big-moneyed” investors. If that is their purpose, the statutes are both under-inclusive and over-inclusive. They are under-inclusive because corporate ownership is only one way such investors can become involved in farming. Through limited partnerships, leasing instead of owning farm operations, or marketing contracts for farm production, the “big-moneyed” investors can have as much involvement in farming as if they’d used the corporate form of operation. On the other hand, restrictions on farm corporations may actually hurt the family farm they were designed to help. Debt financing as a means of sustaining or expanding a farm operation may not be feasible due to high interest costs or high debt service payments required. Equity financing, through non-farm investor capital, or through neighboring farms combining operations to eliminate wasteful duplication, could be an attractive alternative to such indebtedness. But in states where farm corporations are restricted, many avenues of such equity financing may be foreclosed. By denying these opportunities to the family farmer, the state may have harmed the farmer more than they’ve helped him. This does not seem to be generally realized, though, and it would not be surprising to see the current farm crisis spawn more such restrictive laws.

A farm need not be of a certain size, or market a certain amount of products before it can consider incorporation. Small or large farms may benefit from choosing a corporate structure. But incorporation is not for everyone. Before undertaking incorporation, each farmer should seek individual professional advice to enable him to accurately assess the effect such a move would have on his operation. Tax savings (or losses) should be weighed against increased costs incurred by incorporating and the burden of maintaining corporate records. The farmer’s mode of operation, expansion plans and estate considerations should be evaluated against the corporate form to determine whether incorporation would aid or hinder this particular operation. Liability, bankruptcy and tax risks of incorporation should be considered to determine if they outweigh incorporation advantages. The ability of the operator to adhere to the formalities a corporate structure requires should also be honestly assessed. Finally, the farmer should have a good reason for incorporating. He should have some discernible gain he hopes to derive from the change in business format. Incorporating just because the neighbors are incorporating may not be enough reason. The attorney counseling the farmer should discourage change just for change’s sake; corporate expenses and formalities are too significant for that.

Farm incorporation, despite its problems and requirements, can provide a host of advantages and benefits to the farm operator. But it is not for everyone.

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