1958

Incorporating the Farm Business: Part I

Minn. L. Rev. Editorial Board

Notes

Incorporating the Farm Business: Part I†

An attorney will be better able to advise his farm owner clients whether or not to incorporate their particular farm businesses after weighing, with reference to the circumstances of each case, the practical considerations outlined and discussed in this Note. The Note will be published in two parts: Part I discusses the relative importance of the limited liability, transferability of ownership and several other considerations, while Part II, to appear in a later issue, will treat the consequences of incorporating on the owner's liability for income, estate, gift and other taxes.

IN 1892 the State of Minnesota granted a corporate charter to the Kenfield Stock Farm Company for the following stated purpose:

> The general nature of the business of this company shall be the . . . handling and disposing of horses, cattle, sheep and other domestic animals, and the buying, owning, improving, operating, leasing, selling, and disposing of farm . . . lands. . . .[1]

Although this charter has expired, the Kenfield Company was the prototype of many farm corporations still in existence.[2] Of the 84 corporate charters known to have been granted by Minnesota, 52 have been granted since 1950.[3] This increasing popularity[4] of farm

† This Note is the outgrowth of a cooperative study undertaken in 1958 by the University of Minnesota Law School and the Department of Agricultural Economics, Institute of Agriculture of the University of Minnesota. It is a contributing study in North Central Regional Project NC-15, How Young Families Get Established in Farming. See Note, *Minnesota Land Contract Law in Action*, 39 MINN. L. REV. 93 (1954), based on an earlier contribution to the same basic project.

1. The articles of incorporation of the Kenfield Stock Farm Company are on file at the Office of the Secretary of State in the capitol building at St. Paul, Minnesota, along with all articles of Minnesota corporations.

2. Earlier farm corporations may exist, although none were discovered. There is no question but that large farm corporations exist in other states. In fact "most of the . . . [individual soil bank payments in 1957 of over $50,000] went to corporation farms." N.Y. Times, Dec. 24, 1957, § 1, p. 1, col. 1.

3. The study of corporate farming undertaken at the University of Minnesota attempted to locate as many farm corporations as possible. Although some names were found by chance flipping through file cards at the Office of the Secretary of State, most names of farm corporations were obtained from one of three sources: (1) lists kept by County Agricultural Stabilization and Conservation Committees, (2) a mail survey of county agents (resulting in a 100% return of Minnesota's 91 county agents), and (3) a mail survey of vocational agricultural instructors in Minnesota high schools. Certainly, the likelihood is great that not all farm corporations within the state were discovered in this study.

Though the amount of authorized capital that is stated in the articles of incorporation is usually of little significance in determining actual value of the corporation, it is

business incorporation during the past few years indicates that the corporate form may offer a solution to some of the special problems confronting today's farm owners. The purpose of this Note is (1) to examine the relevant characteristics of the corporate form of organization in relation to some of the special problems facing farm owners, and (2) to discuss in some detail the considerations that will determine whether or not a *particular* farm business should be incorporated.[5]

Survey of State Law Governing Farm Incorporation

Corporation statutes of all but one state provide generally for incorporation for any lawful purpose not expressly prohibited.[6] For

interesting to note that the range of capitalization of these Minnesota corporations was from $25,000 to over $200,000. Of course, several corporations provide only for no-par value stock and do not assign them any value in the articles of incorporation.

4. This increase in farm incorporation has encouraged agricultural departments at several colleges and universities to prepare bulletins on farm incorporation for distribution to farmers. See, *e.g.*, KRAUSZ & MANN, CORPORATIONS IN THE FARM BUSINESS (University of Illinois Extension Service in Agriculture and Home Economics Circular No. 797, 1958); Eddy, Incorporating the Family Farm (Vermont Agricultural Extension Service Brieflet 1003, undated); Smith, Incorporation of the Farm Business (Department of Agricultural Economics, Cornell University Agricultural Experiment Station, A.E. 831, 1953).

5. The term "farm business" in this Note refers to farming in general, whether done on a large or small scale. No attempt has been made to distinguish, as one writer does, between the "Farm Family Theory of Tenure" and the "Farm Business Theory of Tenure," the latter being the one under which farms could get as big as the ability of the manager would allow, whereas size under the former would be restricted. See Crossmon, *Research into Management Problems of Corporate Farming*, 35 J. FARM ECONOMICS 953 (1953).

6. ALA. CODE ANN. tit. 10, § 1 (1940); ALASKA COMP. LAWS ANN. § 36–2A–11 (Supp. 1958); ARIZ. REV. STAT. ANN. § 10–121 (1956); ARK. STAT. ANN. § 64–101 (1947); CAL. CORP. CODE ANN. § 300 (West 1955); Colo. Laws 1958, ch. 32, § 3; CONN. GEN. STAT. § 5151 (1949); DEL. CODE ANN. tit. 8, § 101 (1953); FLA. STAT. § 608.03 (1957); GA. CODE ANN. § 22–1801 (Supp. 1955); IDAHO CODE ANN. § 30–102 (1947); ILL. REV. STAT. c. 32, § 157.3 (1957); IND. STAT. ANN. § 25–201 (Burns 1933); IOWA CODE § 491.1 (1958); KAN. GEN. STAT. ANN. § 17–2701 (1949); KY. REV. STAT. ANN. § 271.025 (Baldwin 1955); LA. REV. STAT. ANN. § 12:2 (1950); ME. REV. STAT. ANN. c. 53, § 8 (1954); MD. ANN. CODE art. 23, § 3 (1957); MASS. ANN. LAWS c. 156, § 6 (1948); MICH. STAT. ANN. § 21.3 (Supp. 1957); MINN. STAT. § 301.03 (1957); MISS. CODE ANN. § 5309 (1942); MO. ANN. STAT. § 351.020 (1952); NEB. REV. STAT. § 21–102 (1943); NEV. REV. STAT. § 78.030 (1957); N.H. REV. STAT. ANN. § 294.2 (Supp. 1957); N.J. STAT. ANN. § 14:2–1 (1937); N.M. STAT. ANN. § 51–2–6 (1953); N.Y. STOCK CORP. LAW § 5; N.C. GEN. STAT. § 55–5 (Supp. 1957); N.D. Laws 1957, ch. 102, § 3; OHIO REV. CODE § 1701.03 (Page Supp. 1957); OKLA. STAT. ANN. tit. 18, § 1.9 (1951); ORE. REV. STAT. § 57.025 (1957); PA. STAT. ANN. tit. 15, § 2852–201 (Purdon 1958); R.I. GEN. LAWS c. 2, § 7–2–3 (1956); S.C. CODE § 12–52 (Supp. 1958); S.D. CODE § 11.0201 (1939); TENN. CODE ANN. § 48–103 (1956); TEX. BUS. CORP. ACT art. 2.01 (1955); UTAH CODE ANN. § 16–2–1 (1953); VT. REV. STAT. § 5754 (1947); WASH. REV. CODE § 23.12.010 (1952); W. VA. CODE ANN. § 3016 (1955); WIS. STAT. § 180.03 (1957); WYO. COMP. STAT. ANN. § 44–101 (1945).

The 1956 revision of the Virginia Stock Corporations Act omitted the section of the old act (§ 13–23) which stated that corporations may be formed for any lawful busi-

example, Ohio provides that "a corporation may be formed for *any purpose or purposes*, other than for carrying on the practice of any profession, for which natural persons lawfully may associate themselves. . . ."[7] Montana, on the other hand, allows incorporation only for purposes expressly provided for in the statutes, but "raising, processing, storing, buying, and selling of all agricultural, horticultural, and other farm products, including grains, fruits, all classes of farm animals and their products," are permissible corporate purposes.[8]

Only two states do expressly prohibit corporation farming. North Dakota provides that "all corporations, both domestic and foreign . . . are hereby prohibited from engaging in the business of farming or agriculture."[9] The statute does not apply to cooperative corporations, however, if at least seventy-five per cent of their members are farmers;[10] nor does it prohibit incorporation for the purpose of farming in another jurisdiction. Kansas provides that corporations cannot be formed for producing "wheat, corn, barley, oats, rye, potatoes or the milking of cows for dairy purposes."[11]

Minnesota and Mississippi place a quantitative limit on the amount of land a farm corporation may acquire or hold. Minnesota limits acquisition of land to no more than 5,000 acres,[12] while Mississippi limits the amount of land any corporation may hold and cultivate to 12,500 acres.[13] The remaining states either limit the corporate holdings to an amount necessary to accomplish the corporate purposes,[14] or have no limiting provision.

Probably all states except Wyoming which allow incorporation for

---

ness purpose, but the language in many of the new sections indicates that a corporation may still be formed in Virginia for any lawful business purpose. See VA. CODE ANN. §§ 13.1–2(c), 13.1–49(c), 13.1–50 (1956) and the revisor's notes following § 13.1–50 in the REPORT BY THE CODE COMMISSION OF VIRGINIA FOR REVISION OF LAWS RELATING TO CORPORATIONS, SEPTEMBER 1955.

7. OHIO REV. CODE § 1701.03 (Page Supp. 1957). (Emphasis added.)

8. MONT. REV. CODES ANN. § 15–104 (1947).

9. N.D. REV. CODE § 10–0601 (1943). In 1956 the North Dakota legislature passed a new Business Corporations Act, but this had no effect on the prohibition against corporate farming. N.D. Laws 1957, ch. 102, § 140.

10. N.D. REV. CODE 10–0604 (1943). Fifteen or more persons are required to form a North Dakota cooperative corporation. N.D. REV. CODE § 10–1502 (1943).

11. KAN. GEN. STAT. ANN. §§ 17–202a, –2701 (1949).

12. MINN. STAT. § 500.22 (1957).

13. MISS. CODE ANN. § 5329 (1942).

14. For example, OKLA. CONST. art. XXII, § 2 (Supp. 1958), provides:

> [N]or shall any corporation doing business in this State buy, acquire, trade, or deal in real estate for any purpose except such as may be located in such [incorporated] towns and cities and as additions to such towns and cities, and further except such as shall be necessary and proper for carrying on the business for which it was chartered or licensed. . . .

For a decision construing the words "and further except," see Texas Co. v. State *ex. rel.* Coryell, 198 Okla. 565, 567, 180 P.2d 631, 634 (1947).

farming purposes would allow incorporating a farm business together with other nonagricultural businesses.[15] Wyoming restricts incorporation to only "one general line or department of business." [16]

I. Incorporation: The Considerations

After several years of field investigation in farming communities, one lawyer has asserted:

> [M]any farm businesses now being operated as sole proprietorships or partnerships would benefit if organized as . . . corporation[s].[17]

The principal "benefits" a farm owner might derive from incorporating his business fall within the areas of (1) limited liability, (2) transfer of ownership and (3) taxation. This section is intended to examine the considerations in the first two of these areas, and also to discuss several other minor considerations that have some bearing on whether or not a particular farm business should be incorporated. The tax considerations will be treated separately in Part II.

A. Limited Liability

The most common reason for incorporating a farm business, according to the Minnesota survey, is to obtain limited liability.[18]

Limited Liability Concept

As a general rule, absent statutory provisions to the contrary, shareholders are not personally liable for the debts of their corporation; their risk is limited to the amount of their investment plus any unpaid stock subscriptions.[19] But this rule must be qualified somewhat. First, if the stock issued to the shareholder is "watered," that

15. It is not clear from the language of some statutes whether or not they allow incorporation for more than a single purpose. The difficulty of interpretation can be best pointed out by comparing a statute which states that incorporation is permissible for "any lawful business," Nev. Rev. Stat. § 78.030 (1957), with a statute stating that incorporation is permissible for "any lawful business *or businesses*," Ala. Code Ann. tit. 10, § 1 (1940). (Emphasis added.) Clearly under the latter several businesses could be incorporated together. The former is not so clear.

16. Wyo. Const. art. 10, § 6. Texas does impose a minor limitation on the types of businesses which may be incorporated together with a cattle raising business. See Tex. Bus. Corp. Act art. 2.01B(3a) (1955).

17. Eckhardt, *Should the Farmer Incorporate?*, 1 Prac. Law. 61, 70 (1955).

18. A standard questionnaire was used in this survey, asking the incorporator to desginate his reason for incorporation from among the following list: "Income Tax Advantages," "Means of Distribution of Income," "Estate Settlement (transferring ownership ease)," "Social Security Purposes," "Limited Liability," and "Other (explain)." Twenty-six of the thirty-two incorporators interviewed disclosed their reasons for incorporating. Of these, twelve chose "Limited Liability" as their principal reason for incorporating; seven chose "Estate Settlement"; six chose "Income Tax Advantage"; and one chose "Social Security Purposes."

19. United States v. Stanford, 161 U.S. 412, 429 (1896).

is, if the value given for the stock was less than the par or stated value[20] of the stock itself, the shareholder may be liable to creditors of the corporation to make up the overvaluation.[21] Thus, if a farmer contributes land and equipment worth $50,000 to the corporation in exchange for stock of either par or stated value of $100,000, he may be held personally liable for up to $50,000 of unpaid corporate debts. Most states apply a *constructive fraud theory* (reasoning that a creditor relies on the shareholder's implied representation that his shares are fully paid) limiting recovery from holders of "watered" shares to subsequent creditors who have no notice of the overvaluation.[22] The rationale is that neither persons offering credit to the corporation before the shareholder purchased watered stock,[23] nor creditors with notice of the overvaluation could have relied on the shareholder's implied representation. However, some states have enacted statutes requiring payment of full par value for par shares, and in these states even prior creditors or creditors with notice of the overvaluation may recover from purchasers of "watered" shares.[24] Of course, the shareholder will be liable under either theory only if the corporation is insolvent.[25]

Since the farmer's contribution to the corporation is usually property rather than money, a valuation problem will often arise in determining whether his stock was watered. But the whole problem of watered stock can easily be avoided by issuing shares with very low par value.[26] Total par value of the corporation's stock (or total stated

20. "Stated value" refers to no-par stock.

21. The price [for the shareholder's immunity from personal liability for corporate debts] is—compliance with legal requirements governing consideration for shares. Herein lies the true meaning of the overworked phrase 'limited liability.' In terms of corporate finance, a shareholder's liability is limited to the capital contribution represented by his shares. In more precise legal terms, an allottee must pay for his shares the full amount required by law. If he has, he is free of further liability; if he does not, he may be held accountable for the deficiency under given circumstances.

Cataldo, *Limited Liability and Payment For Shares*, 19 U. PITT. L. REV. 727 (1958). The author then goes on to discuss the difficult problems of determining whether or not full value has been paid for the shares of stock.

22. See the leading case of Hospes v. North Western Mfg. & Car Co., 48 Minn. 174, 50 N.W. 1117 (1892).

23. This situation will seldom arise in a farm corporation case since the principal shareholders will normally become shareholders at the time the corporation is formed.

24. See, *e.g.*, Easton Nat'l Bank v. American Brick & Tile Co., 70 N.J. Eq. 732, 64 Atl. 917 (Ct. Err. & App. 1906); Cooney Co. v. Arlington Hotel Co., 11 Del. Ch. 430, 106 Atl. 39 (Sup. Ct. 1918).

25. Until insolvency the plaintiff-creditor has not been injured since there are corporate assets which he can reach.

26. Low par stock is probably more often used than no-par stock. The principal reason for this is the difference in federal stamp tax rates on the two types of stock. Under INT. REV. CODE of 1954, § 4301(1) the stamp tax on par value stock is "eleven cents on each $100 or fraction thereof of the par or face value of each certificate," while under § 4301(2) no-par stock is taxed as follows:

value of no-par stock) need not equal the actual value of the shareholder's contributions; it need only satisfy the minimum stated capital required by state statute.[27]

The second qualification on the limited liability rule is that courts will often look beyond the "corporate veil" and hold the owner personally liable for corporate debts in order to prevent "injustice"[28] or to "enforce a paramount equity."[29] In spite of this obscure language, at least two relevant principles can be gleaned from the case law. First, where the corporation is not actually conducting business as a separate entity it may be considered the "alter ego" of the owner, and disregarded for purposes of limited liability.[30] To obtain limited liability there must be "not only initial corporate organization, but, also, *actual conduct of the business in corporate form by the corporation.*"[31] In determining whether or not the corporation is a separate entity

> proof of commingling of personal and corporate funds, payment of personal expenses from corporate funds, disregard of the corporation as a separate entity in transactions and bookkeeping, and nonconformity to corporation laws requiring the holding of stockholders' and directors' meetings, will all be of significance.[32]

The moral of this principle is: when organizing a farm corporation, the attorney must make certain that it will comply with the state corporation laws and operate in all respects as an entity distinct from its shareholders. Since farm corporations frequently have only a very few shareholders, the alter ego problem should be carefully considered. However, the mere fact that only one or two shareholders have complete control over the corporation "is not sufficient ground for disregarding corporate personality."[33]

(A) Actual value of $100 or more per share. — Eleven cents on each $100 or fraction thereof of the actual value of each certificate. . . .

(B) Actual value of less than $100 per share. — Three cents on each $20 or fraction thereof of the actual value of each certificate. . . .

27. In Minnesota, for example, the corporation must have stated capital of at least $1,000. MINN. STAT. § 301.04 (1957). Additional contributions could be credited to paid-in surplus.

28. See, *e.g.*, *In re* Zipco, Inc., 157 F. Supp. 675, 677 (S.D. Cal. 1957); Appleby v. Wallins, 142 N.E.2d 339, 341 (Mass. 1957).

29. See, *e.g.*, Winand v. Case, 154 F. Supp. 529, 540 (D. Md. 1957).

30. See, *e.g.*, Murray v. Wiley, 169 Ore. 381, 400, 127 P.2d 112, 119 (1942); Larson v. Western Underwriters, Inc., 87 N.W.2d 883 (S.D. 1958).

31. P. S. & A. Realties, Inc. v. Lodge Gate Forest, Inc., 205 Misc. 245, 254, 127 N.Y.S.2d 315, 324 (Sup. Ct. 1954). (Emphasis added.)

32. Schifferman, *The Alter Ego*, 32 CALIF. S.B.J. 143, 155 (1957).

33. Cataldo, *Limited Liability With One-Man Companies and Subsidiary Corporations*, 18 LAW & CONTEMP. PROB. 473, 475 (1953). "The mere fact that all of the corporate stock is held by one person who exercises sole control over the corporation is insufficient to justify disregarding the corporate entity." *In re* Zipco, Inc., 157 F. Supp. 675, 677 (S.D. Cal. 1957).

A few courts require some element of fraud or injustice to the plaintiff, in addition

Second, the corporate veil may be pierced when there has been "an *obvious inadequacy of capital*, measured by the nature and magnitude of the corporate undertaking."[34] "Capital" here refers to net worth,[35] and is considered in relation to the volume of business and the extent of indebtedness of the corporation. Although courts seldom consider a corporation's capital so inadequate as to justify enforcing corporate debts against the shareholders personally,[36] attorneys should be hesitant to approve a plan whereby the corporation will lease most of its property from the shareholder. If the corporation is to carry on a substantial volume of business and incur substantial debts, it should own a correspondingly substantial amount of tangible assets to avoid being deemed inadequately capitalized for its business.

Of course, the shareholder will be personally liable to the plaintiff if he caused the plaintiff's injury, even though his tortious conduct occurred while he was acting as agent for the corporation.[37] Therefore, a farmer who negligently injures someone cannot escape personal liability by proving that he was acting in his capacity as employee of the farm corporation, since liability in such a case has nothing to do with the corporation-shareholder relationship.

Importance of Limited Liability to the Farm Incorporator

The concept of limited liability applies both to tort and contractual liability of the corporation. A farm owner may, however, be able to reduce his *tort* liability through insurance, though apparently very few farm owners have done so in the past.[38] Since adequate insurance would prevent *any* loss resulting from injury to others, it is far better protection for the farm owner than limited liability which only insulates personal assets against that type of loss. For that reason, even many farm corporations carry insurance covering general tort liability.[39] However, the premiums on these policies are often

to a finding of "alter ego," before the corporate veil will be pierced. See, *e.g.*, Wood Estate Co. v. Chanslor, 209 Cal. 241, 245, 286 Pac. 1001, 1002 (1930). See also generally Schifferman, *The Alter Ego*, 32 CALIF. S.B.J. 143 (1957).

34. Anderson v. Abbott, 321 U.S. 349, 362 (1944). (Emphasis added.)

35. Net worth is equal to the corporation's total assets minus its total liabilities, or, stated in different terms, to the sum of stated capital and surplus. "Capital," for purposes of the inadequate capital rule, is *not* limited to stated capital as distinguished from paid-in surplus.

36. See 56 MICH. L. REV. 299, 300 (1957).

37. 35 AM. JUR. *Master and Servant* § 587 (1941). Also, it should be remembered that the stockholder does not become exempt from tort or contractual liability which is unconnected with the corporate business, and the shares of stock of his corporation which he holds may be subject, as personal assets, for such liability.

38. See Shoemaker, *Incorporation of Family Agricultural Businesses*, 30 ROCKY MT. L. REV. 401, 404 (1958).

39. Several of the farm incorporators interviewed in Minnesota had tort liability insurance.

high, and the insured can never be certain that he has full coverage, since he will always be personally liable to the extent that any judgment against him exceeds his insurance coverage. Therefore limitation of tort liability of the farm business is a relevant consideration. Since insurance against *contract* liability is impractical, that type of liability should also be considered.

The concept of limited liability for corporate shareholders can be quite advantageous to the farm owner, since farming is a relatively speculative business involving substantial financial risks.[40] There are four typical situations in which a farm business might be incorporated: (1) where an individual farmer is engaged exclusively in farming, (2) where an individual farmer owns property or businesses unrelated to his farm, (3) where an investor finances a farm but does not manage it himself, and (4) where several persons share in the ownership of the farm. Each of these raises somewhat different considerations as to the importance of limited liability.

(1) The Individual Farmer. If an individual farmer should incorporate his farm business and transfer all his assets to the corporation, there would be no limited liability advantage since these assets would still be subject to satisfying liabilities incurred by the business. In fact, in some instances the change could be disadvantageous. If, for example, the farmer includes his homestead in the property he transfers to the corporation, he would probably lose the benefit of the homestead exemption from attachment for personal debts normally given to him under state law.[41] However, an incorporator need not

40. "[Farming] is a highly speculative undertaking, dependent for success not only upon the ability of management, but also upon the vagaries of weather and political winds blowing out of Washington." Schwerzmann, *Problems in Estates Involving Farms and Small Businesses*, 28 N.Y.S.B. BULL. 399, 405 (1956). In any given year a farmer could sustain a tremendous loss. For example, "on Friday, April 13, 1929, a disastrous rainstorm washed away petitioner's strawberry beds, causing a loss of $138,000." Highland Farms Corporation, 42 B.T.A. 1314, 1316 (1940).

41. For example, MINN. STAT. § 510.01 (1957) provides: "[T]he homestead . . . [shall] be exempt from seizure or sale under legal process on account of any debt not lawfully charged thereon in writing. . . ."

The Minnesota statute defines "homestead" as "the house *owned and occupied* by a debtor as his dwelling place, together with the land upon which it is situated. . . ." *Ibid.* (Emphasis added.) Perhaps it could be argued that where the corporation is a sole stockholder enterprise, the house and land does not lose its homestead status merely because ownership in the individual is now represented indirectly by shares of stock. Technically, the corporation owns the house and land but actually the shareholder does. This argument might be extended to the situation where the corporation is a family enterprise; however, when outside capital is invested in the corporation, the house is certainly no longer "owned and occupied" by the farmer.

Other assets are exempted by MINN. STAT. §§ 550.37(6), (11), (1957). Among these are:

> Three cows, ten swine, a span of horses or mules or in lieu of such span of horses or mules, one farm tractor, 100 chickens, 50 turkeys, 20 sheep, and the wool from the same . . . food for all the stock above mentioned necessary for one years support, either provided or growing, or both, as the debtor may choose; one

transfer all his assets to the corporation, even though they are necessary to the farming business. He can retain ownership of some of the assets and lease or rent them to the corporation,[42] although he must be careful to avoid retaining ownership of so many of the assets that his farm corporation could be considered inadequately capitalized for the purposes of piercing the corporate veil. Consequently there may be many farmers who do not have sufficient assets, beyond those already exempted from attachment under local law, to enable them to benefit from the limited liability concept.

(2) The Farmer Owning Other Property or Businesses. A farmer owning an appreciable amount of property unrelated to the farm will probably be very interested in insulating that property from the liabilities of the farm business. However, when the farmer owns other small businesses which are unrelated to the farm, he might find that there are advantages in forming all the businesses into one corporation[43] that outweigh the advantages of incorporating them separately.

(3) The Owner Taking No Active Part in Operating the Farm. Here again the farm owner will probably also own property unrelated to the farm business. Since he is not taking an active part in operating the farm, however, he is apt to be even more reluctant than a person who does operate his own farm to subject other assets to liability arising out of the farm enterprise.

(4) Several Persons Sharing Ownership of a Farm. When several persons decide to share jointly in a farm enterprise, they will probably choose either the partnership or the corporate form of organization.[44] Many factors are relevant to this choice,[45] but only by incor-

---

wagon, cart, or dray, one sleigh, two plows, one drag; and other farming utensils, including tackle for teams, not exceeding $300 in value;

. . . .

Necessary seed for the actual personal use of the debtor for one season, not to exceed in any case the following amounts. . . .

The exemptions of the former paragraph apply only to debtors "having an actual residence in the state." MINN. STAT. § 550.37 (1957).

42. Several Minnesota farm incorporators owned their homestead property. That homestead land may be necessary to the farming enterprise is obvious, since the rural homestead may include "any quantity of land not exceeding 80 acres. . . ." MINN. STAT. § 510.02 (1957).

43. For example, the expense of forming two or three separate corporations may be prohibitive, and the red tape—documents and bookwork—connected with several corporations would be substantial.

The farm owner might have a business which involves more risk than does the farm business. One writer has raised a very persuasive example, that of the farm owner who also has an artificial insemination business. Valuable cows could be harmed in the process of artificial insemination, thereby subjecting the business owners to heavy tort liability. Having this business enterprise incorporated separately from the farm business would protect the assets of the farm. See Eckhardt, *Should the Farmer Incorporate?*, 1 PRAC. LAW. 61, 62 (1955).

44. The group might consider a cooperative form of organization, although cooperatives are not normally designed to meet this type of situation. However, in many

porating the enterprise can the respective liabilities of all the joint owners be limited. Each member of a partnership can be held liable to the full extent of any partnership obligations, whether incurred by himself or another partner.[46] Thus, the more persons that are to take part in ownership of the farm business, the more likely it is that each would want to limit his liability.

Incorporation might be advantageous to the farmer who needs additional capital but wants it as an investment and not as a loan, since a prospective investor will be more attracted to an enterprise operating under a form of organization which guarantees him limited liability.[47]

Limitation on Advantage of Limited Liability

The importance of limited liability would be reduced considerably if a prospective creditor of the corporation required the principal shareholder or shareholders to sign the corporation's contracts both personally and as agents of the corporation, thus making them guarantors of the corporation's obligation.[48] Although creditors usually do not require the personal guarantee of the farm owner in the ordinary small sales transactions, such as monthly gasoline purchases, they might often do so on a bigger sales transaction, such as the purchase of new farm machinery or a new herd of cattle. A bank or loan company lending money to the corporation will almost invariably

states cooperative farms, as distinguished from cooperative farm product marketing associations, are not sanctioned by law. For example, the Tennessee statutes provide only for cooperative *marketing* associations and electric cooperatives. TENN. CODE ANN. §§ 43–1801 to –1849, 65–2501 to –2533 (1955). On the other hand the Minnesota statute provides: "A cooperative association may be formed for the purpose of conducting any agricultural, dairy, marketing, . . . business, or for all such purposes. . . ." MINN. STAT. § 308.05(1) (1957). Practical effect has been given to this section by the Wagner-Altermatt Cooperative Association under the following stated purpose:

> The purpose of this association shall be to engage in a production, purchasing, processing, manufacturing and marketing business upon the cooperative plan. The general nature of its business shall be the producing, processing, handling and marketing of grain, milk and dairy products, livestock, poultry and other products of the farm; and the purchasing, handling and distributing of feeds, poultry, livestock and other farm supplies and equipment.

Articles of Incorporation on file at the Office of the Secretary of State of Minnesota.

The peculiar problems of cooperatives are many and difficult, and discussion of them here would be beyond the scope of this Note. See generally PACKEL, COOPERATIVES (3d ed. 1956).

45. The principal consideration would probably be the tax consequences. Reference should be made to the appropriate discussion in Part II of this Note.

46. See UNIFORM PARTNERSHIP ACT § 15. As of 1957 this act had been adopted by thirty-seven states including Minnesota. See the table in the 1957 supplement to the act, at p. 6.

47. At least one Minnesota farm corporation was formed at the insistence of an investor who refused to invest in a partnership offering no limited liability.

48. See BEUSCHER, LAW AND THE FARMER 150 (2d ed. 1956).

demand the farm owner's personal signature. When the farm owner does sign personally, he becomes responsible to the extent the corporation fails to discharge its debt. This qualification on the limited liability concept, of course, applies only to *contractual* and not to tort liability.

Other Forms of Business Organization Providing Limited Liability.

Owners are allowed to limit their liability under two other forms of business organization: (1) the limited partnership and (2) the limited partnership association.[49]

(1) Limited Partnership. A limited partnership is defined as

> a partnership formed by two or more persons . . . 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 obligations of the partnership.*[50]

Only the general partners manage the business, and *they are liable to the full extent of partnership debts.* The limited partner "'is not in any sense a partner,' but rather stands in the same position as a shareholder in a corporation; he is, in effect, an investor with limited liability."[51] Consequently the limited partnership is no help to a person who wants to take part in managing the farm.[52] And perhaps

49. The Massachusetts business trust and the joint stock company, which have been said to be adaptable to farming operations in some parts of the country, will not be considered. See BEUSCHER, LAW AND THE FARMER 153–54 (2d ed. 1956).

50. UNIFORM LIMITED PARTNERSHIP ACT § 1. (Emphasis added.) This act has been adopted in 36 states including Minnesota. See the list of states in 8 U.L.A. at 6 (Supp. 1957). Ohio can now be added to this list. See OHIO REV. CODE §§ 1781.01–.27 (Page Supp. 1958). The twelve states not on that list also allow the formation of limited partnerships. ALA. CODE ANN. tit. 43, §§ 6–27 (1940); CONN. GEN. STAT. §§ 6276–84 (1949); DEL. CODE ANN. tit. 6, §§ 1701–12 (1953); KAN. GEN. STAT. ANN. §§ 56–101 to –121 (1949); KY. REV. STAT. ANN. §§ 362.010–.130 (Baldwin 1955); LA. CIV. CODE ANN. arts. 2828, 2838–51 (West 1952) (referred to as partnerships *in commendam*); ME. REV. STAT. ANN. c. 181, §§ 17–26 (1954); MISS. CODE ANN. §§ 5553–70 (1956); N.D. REV. CODE §§ 45–0301 to –0326 (1943) (referred to as "special or limited" partnerships); ORE. REV. STAT. §§ 69.010–.130 (1957); S.C. CODE §§ 52–101 to –128 (1952); WYO. COMP. STAT. ANN. §§ 61–701 to –725 (1945) (referred to as "special" partnerships). UNIFORM LIMITED PARTNERSHIP ACT § 3 provides: "A limited partnership may carry on any business which a partnership without limited partners may carry on, except [here designate the business to be prohibited]." Statutes in 10 of the other states are similar, clearly allowing limited partnerships for agricultural purposes. In the other states the status of an agricultural limited partnership is doubtful. KAN. GEN. STAT. ANN. § 56–101 (1949) provides: "Limited partnerships for the transaction of any mercantile, mechanical or manufacturing business within this state may be formed. . . ." ME. REV. STAT. ANN. c. 181, § 17 (1954), is almost identical. Perhaps the agricultural business may be characterized as "mechanical."

Some statutes allow limited partners to contribute only cash. See, *e.g.*, ALA. CODE ANN. tit. 43, § 7 (1940).

51. Comment, *The Limited Partnership*, 2 U.C.L.A.L. REV. 105, 108 (1954).

52. The limited partnership has been regarded as "not satisfactory" for coping with the problems of management and continuity of agricultural businesses in Wisconsin. Note, *Limited Partnerships in Family Farm Transfer and Operating Agreements*, 1952 WIS. L. REV. 171.

one who wants to invest in the business and share in its profits without taking part in its management could do so under an ordinary partnership organization as well as under a limited partnership, since, according to the United States Supreme Court, "it is . . . well settled that the *receiving of part of the profits* of a commercial partnership, in lieu of or in addition to interest, by way of compensation *for a loan of money* [does not make the lender a partner]."[53] It is difficult to see much difference between a limited partner who invests and shares in the profits but takes no part in management, and the lender who puts money at the disposal of the business in return for a share in the profits.

Furthermore, a limited partnership will dissolve upon the death or incapacity of a general partner unless the partnership certificate expressly provides otherwise or all the remaining partners agree to continue the business.[54] And if the certificate does provide for the continuing life of the business, the partnership *may* be taxed as a corporation.[55] This would normally defeat the purpose of organizing as a limited partnership rather than a corporation, since tax consequences are usually the principal factors governing the choice between the two.[56]

(2) Limited Partnership Association. Limited partnership associations are devices which "permit a sharing of profits and losses, possession, *and management,* but without the risk of unlimited lia-

53. Meehan v. Valentine, 145 U.S. 611, 624 (1892). (Emphasis added.) See generally CRANE, PARTNERSHIPS 76–80 (2d ed. 1952).

54. See, *e.g.*, UNIFORM LIMITED PARTNERSHIP ACT § 20.

55. If the certificate grants such right [the right to continue the business after a general partner's retirement, death or insanity] to the remaining general partners, there is little doubt but that the Service would contend that this is sufficient continuity of life to classify the partnerships as an association. [An association is taxed in the same manner as a corporation.]

To assure partnership status, the limited-partnership agreement should be drafted to provide for partnership dissolution upon retirement, death, or insanity of a general partner.

Heard, *How to Avoid the Taxation of Limited Partnerships as Corporations*, 6 J. TAXATION 298, 299 (1957). One method of avoiding the commissioner's argument is to provide in the certificate that if the remaining partners agree among themselves to continue they may do so. The partners could then contract with each other to agree to continue. See, however, Western Construction Co., 14 T.C. 453, 468 (1950), holding a limited partnership not to be taxable as a corporation though article X of the partnership agreement had provided: "the right is hereby given to the remaining General Partners to continue the business upon the death or retirement of a General Partner. . . ." *Id.* at 459. It is clear, however, that the more the limited partnership resembles a corporation, the more likely it is to be deemed an association and taxed as a corporation.

Congress may have changed the impact of this by enacting, in 1958, legislation allowing *certain* small business corporations to elect not to be taxed as corporations. Thus, if limited partnerships were worried about being taxed as corporations, they could incorporate to meet the election qualifications and elect not to be taxed as corporations. See INT. REV. CODE OF 1954, §§ 1371–77. An extensive discussion of this 1958 legislation will appear in Part II of this Note.

56. See, *e.g.*, Caudill & Fendler, *The Uniform Limited Partnership Act*, 59 COM.

bility."[57] However, this form of business organization is recognized in only four states — Michigan,[58] New Jersey,[59] Ohio,[60] and Pennsylvania.[61] Although the limited partnership association would allow limited liability of all members, whether or not they took part in managing the business, it might be unsatisfactory for farm businesses in other respects. For example, the law regarding limited partnership associations is so sparse that it is not clear how courts will treat them;[62] the life of the association is not perpetual; and the association is not a "citizen" for purposes of federal diversity jurisdiction.[63] Furthermore, an association will normally be taxed as a corporation rather than as a partnership.[64] However, the ease with which an association can be formed may encourage small enterprises to favor that form of organization.

B. Transfer of Ownership and Estate Planning

A farm owner is often interested in transferring ownership of part of his farm *business*, as distinguished from ownership of specific pieces of land or equipment, since the specific property is usually necessary for the continuing operation of his business.[65] However, problems may arise both in relation to inter vivos transfers and to estate planning. Corporate ownership might prove beneficial when, for example, a farmer wants to obtain additional capital for business purposes, to give part interests to farm employees to provide further incentive for them,[66] or to distribute some or perhaps even all of his farm property to his family or friends. This latter transfer may be

L.J. 5 (1954). One reason given by these authors for someone's wanting to use the limited partnership form instead of the corporate form is that corporate income is taxed twice — once when it is income to the corporation and again when it becomes income to the shareholder in the form of dividends. See, however, the discussion of double taxation in Part II of this Note.

57. Note, *Limited Partnerships in Family Farm Transfer and Operating Agreements*, 1952 Wis. L. Rev. 171, 172. (Emphasis added.)

58. Mich. Stat. Ann. §§ 20.91–.107 (1937), as amended, Mich. Stat. Ann. § 20.95 (Supp. 1957).

59. N.J. Stat. Ann. §§ 42:3–1 to –30 (1940), as amended, N.J. Stat. Ann. §§ 42:3–6, –9, –11, –16, –19 to –28 (Supp. 1957).

60. Ohio Rev. Code §§ 1783.01–.12 (Page 1954).

61. Pa. Stat. Ann. tit. 59, §§ 341–484 (Purdon 1930), as amended, Pa. Stat. Ann. tit. 59, §§ 441–42 (Purdon Supp. 1957). See Pa. Stat. Ann. tit. 59, §§ 241–321 (Purdon 1930), for the "registered partnership" which is a variation of the partnership association.

62. See generally Crane, Partnerships 118–20 (2d ed. 1952); Note, *The Limited Partnership Association in New Jersey*, 10 Rutgers L. Rev. 701 (1956).

63. Great Southern Fire Proof Hotel Co. v. Jones, 177 U.S. 449 (1900).

64. See Note, *supra* note 62, at 711–13.

65. For example, a farmer owning a barn valued at $5,000 is probably not going to transfer full or partial interest in that barn to anyone.

66. Certainly providing incentive for better performance on the part of employees would be beneficial; however, profit sharing plans are often adopted to accomplish this end without incorporating the business.

designed either to avoid the burdensome federal and state estate taxes or to gradually transfer ownership to the person who is to run the farm after the owner's death.

Inter Vivos Transfers

Although the owner of an unincorporated farm could transfer an interest in his farm *business* only by entering a partnership agreement,[67] he could transfer an undivided interest in his farm *property* without doing so. But deeding out an undivided interest in farm property is much less convenient than transferring shares of stock,[68] and, furthermore, it may create difficult problems of joint-ownership.[69] Since the owner of an undivided interest in property can sell that interest to a third person,[70] the principal problem is in retaining control over the farm property as a unit,[71] both for purposes of operating the farm business and of keeping the property within a small group — the typical family farm. Furthermore, any deed provision attempting to restrict the owner's right to sell his undivided interest would probably be considered void as a restraint on alienability.[72]

When the farm owner incorporates, however, he becomes the owner of corporate shares rather than farm property. As a result, he can distribute shares of stock representing part interest in the farm business and still retain control over the operations of the farm.[73] Furthermore, he can be certain that such shares will never be publicly sold by requiring that all stock must be offered for sale to other shareholders before being offered to the public.[74]

67. There are other forms of noncorporate organization not too frequently used, such as the cooperative, limited partnership, and limited partnership association.

68. This is particularly so, if the farm owner wants to gradually transfer ownership of the farm to the person who will operate it after his death. Incorporation would be advantageous also when a buyer does not have sufficient capital to make an outright purchase of the farm; he could purchase varying amounts of the stock over a period of years.

69. See BEUSCHER, LAW AND THE FARMER 71–76, 169 (2d ed. 1956).

70. *Id.* at 73.

71. The problem of retaining control over the whole farm unit also arises where the farm owner deeds out certain parts of the farm property with the understanding that it will all be worked as a single farm. "In the main, there is fear that by parting gradually with a parcel of land here and there by deed, the time might come when the recipient would desire to sell out and the majority owner would be left with only half the land or less, and yet with an operation geared to run the entire deal." Shoemaker, *Incorporation of Family Agricultural Businesses*, 30 ROCKY MT. L. REV. 401, 407 (1958).

72. See generally 41 AM. JUR. *Perpetuities and Restraints on Alienation* §§ 66, 71, 75–77 (1942).

73. In a corporation with only one class of stock, the owner can retain control by transferring less than a majority of the shares. If the corporation has both voting and nonvoting stock, the owner can distribute all the nonvoting stock and a minority of shares of voting stock and still retain control over the business. This type of stock-splitting plan may have adverse tax consequences for the transferor, however; these will be discussed in Part II of this Note.

74. UNIFORM STOCK TRANSFER ACT § 15 allows reasonable restrictions on the

Estate Planning

> [T]he 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.*[75]

Although the corporate form offers definite advantages to the farm owner wanting to distribute some of the interest in his business during his life, perhaps the principal transferability advantages of incorporation apply to distribution of the farm owner's estate when he dies. Incorporating the farm business may greatly facilitate settlement of the estate, since that estate will be much easier to distribute when it consists primarily of stock in a farm corporation rather than the relatively indivisible farm property itself. Typically, the farmer will have several intended beneficiaries, not all of whom would want to live on the farm. He will probably want to leave his farm to those interested in farming it, and still provide for the others in his will.[76] The owner of an unincorporated farm will have difficulty doing this unless he has assets unrelated to the farm business, but the owner of a farm corporation can easily do so in any of several ways. For example, he could leave shares of stock to each beneficiary, but give a majority of the *voting* shares to the one who intends to manage the farm. That beneficiary would, of course, be paid by the corpora-

---

right to transfer stock, provided that they are noted on the face of the stock. See Costello v. Farrel, 234 Minn. 453, 48 N.W.2d 557 (1951). The table in the UNIFORM STOCK TRANSFER ACT at 6 (Supp. 1957) lists 48 states that have adopted the act. The only state not listed, Pennsylvania, repealed its Uniform Stock Transfer Act when it enacted the Uniform Commercial Code, though it still has a similar provision. PA. STAT. ANN. tit. 12A, § 8–204 (Purdon 1954). However one state on the list, Massachusetts, has now also repealed its Uniform Stock Transfer Act having enacted, in 1958, the Uniform Commercial Code. The provision now covering restrictions is MASS. ANN. LAWS c. 106, § 8–204 (Special Supp. 1958), which provides that unless stock restrictions appear on the face of the stock they are of no force except to purchasers with actual knowledge.

On stock restriction agreements see generally O'Neal, *Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting*, 65 HARV. L. REV. 773 (1952).

75. Fleming, *An Over-All Look at Estate Planning*, 45 ILL. B.J. 452 (1957). "Yesterday a farmer began farming with [land and equipment] . . . representing an investment of not more than $4,000 or $5,000. [Today] a farmer who buys a . . . farm will pay in the neighborhood of $200,000 for his land, an additional $20,000 for equipment and stock, and need at least $10,000 in working funds. . . ." *Ibid.*

76. In at least one instance incorporation offered a solution to problems raised by the farmer's *failure* to make a suitable estate plan before he died. In that case the father died intestate, leaving two sons and three daughters. One of the sons had participated in the farm operation for many years and had expected to inherit the farm. . . . The nonfarm heirs refused to sell their interests to the farm operating son because he was childless and they wished the farm to continue in the family indefinitely. . . . [Incorporation was used as the solution, and] the farm operating son–though still bitter because he did not inherit the farm–is well satisfied with the corporate set-up.

Smith, Incorporation of the Farm Business, 15–16 (Department of Agricultural Economics, Cornell University Agricultural Experiment Station, A.E. 831, 1953).

tion for his services, and the income of the corporation would be distributed among all the beneficiaries in proportion to the amount of stock each receives. Or the farm owner could create a trust over the stock to pay the income to designated beneficiaries. The trustee could be instructed to sell a certain number of shares each year to the person who is to manage the farm and to pay the proceeds to the other beneficiaries, until the beneficiary actually operating the business finally owns the whole farm corporation.

As many writers have cautioned, the farmer leaving his farm business as a going concern should be certain that the person to whom he is leaving it can and will continue the operation of the business.[77] If the farm owner does not have intended beneficiaries who will continue the business but he still wants them to own it, he may provide a general manager to operate the farm on the beneficiaries' behalf.[78] Certainly it is no solution to let the farm pass under intestacy for, as has been pointed out: "Many American judges, in this age of mechanized agriculture, refuse to divide moderate to small sized farms into several parcels. Instead the farm is ordered sold at public sale, and the proceeds of the sale are partitioned." [79]

Obviously, the prospective farm incorporator *must* also consider the effect of various methods of stock disposition upon his liability for estate and gift taxes. A discussion of tax considerations will appear in Part II of this Note.

C. Other Considerations

Though limited liability, estate settlement, and taxation are generally the most important considerations in determining whether or not to incorporate a farming business, there are other considerations which could be important in some cases.

Improved Credit Standing

Apparently some farms have been incorporated in an attempt to facilitate borrowing money for the farm business.[80] The authors of

77. See *e.g.*, Fleming, *supra* note 75, at 456; Schwerzmann, *Problems in Estates Involving Farms and Small Businesses*, 28 N.Y.S.B. Bull. 399, 405 (1956).

78. Trust companies are now beginning to provide this service. See Casner, Estate Planning 392–93 (1953).

79. Beuscher, Law and the Farmer 76 (2d ed. 1956).

80. For example, in Highland Farms Corporation, 42 B.T.A. 1314, 1315 (1940), the Board of Tax Appeals said that "petitioner [Highlands] . . . had been incorporated for the purpose of securing the loan from Fidelity. . . ." The loan, however, in that case was also secured by "personal notes." *Ibid.*

The question of "credit standing" which is dealt with in this section is to be distinguished from the point already discussed in this Note of inducement in the form of limited liability that incorporating may provide to prospective *investors*. The fact that the corporation may have an advantage in attracting investment capital has no direct bearing on its credit standing.

one state farm corporation circular assert that:

> Corporate organization, by bringing capital together under a single, unified control, may attract even more capital and improve the credit status of the business.[81]

Three supporting reasons are given for this statement, but they are not very persuasive in the typical family farm situation. "First, a corporation continues to function even though an owner (shareholder) should leave. There is continuity of operation."[82] But whether or not the farm is incorporated, if the owner is operating the farm himself, as he normally would be, and there is no one to take his place, the farm operations will cease when he leaves. Although technically a farm corporation would continue to function as such, in reality many farm corporations just would not be continuing enterprises.[83]

The second reason is that "lenders and investors prefer to deal with the unified and assumedly able management which they expect to find in a corporation."[84] However, since the management would probably continue the same under the corporation as it was before the farm enterprise was incorporated, this reason would be valid only to the extent that investors are fooled into thinking that management becomes more "able" merely by changing to the corporate form of organization.

The third supporting reason is that "the credit of a corporation is not impaired by the individual liabilities of a shareholder."[85] Certainly if the owner already has substantial personal debts, the fact that the corporation is not responsible for those debts often will be decisive.[86] But if the owner incorporates after incurring personal debts, the transaction might look suspiciously like a fraud on creditors, and be disregarded in an action by them.[87] Therefore, when the owner has already incurred personal debts, incorporating his farm business probably would not help the farm's credit rating. If, however, the owner has no outstanding debts, the corporate form offers little more protection to a creditor of the business than he

81. KRAUSZ & MANN, CORPORATIONS IN THE FARM BUSINESS 8 (University of Illinois Extension Service in Agriculture and Home Economics, Circular No. 797, 1958).

82. *Ibid.*

83. The Minnesota survey located several farm corporations which discontinued operations upon the departure of the principal owner (usually his death).

84. KRAUSZ & MANN, *op. cit. supra* note 81, at 8.

85. *Ibid.*

86. The stock and perhaps control of the corporation might change hands if the owner's personal creditor attached the owner's personal assets which, of course, include his stock in the corporation. Nevertheless, in this case the creditors of the corporation would always have claims on corporate assets superior to any claims of personal debtors.

87. See, *e.g.*, Gagnon v. Speback, 389 Pa. 17, 131 A.2d 619 (1957).

could obtain by a preferred credit transaction with an unincorporated farmer. Hence, the credit of the farm business would not be materially improved by incorporation.

Social Legislation Affecting the Farmer

Most social legislation has little if any affect on the farm business, whether or not it is incorporated. For example, Congress provided that the federal minimum wage laws "shall not apply with respect to . . . any employee employed in agriculture. . . ."[88] Also, agricultural labor generally is excluded from unemployment compensation laws.[89] Social security, however, has had historical significance. Prior to 1954 when farmers were not eligible for social security benefits, many farm owners incorporated their farms and became officers of the corporation and thus eligible for those benefits.[90] The officer's salary was commonly the amount necessary to give him the maximum benefits, even though in some instances the corporation had to borrow money to pay that salary. In 1954 this scheme was rendered unnecessary when social security coverage was extended to farmers.[91]

Workmen's compensation laws, however, may have some bearing on the question whether or not the farm owner should incorporate. Although agricultural labor normally is excluded from compulsory coverage under workmen's compensation laws,[92] some states allow employers of agricultural laborers to voluntarily subscribe to workmen's compensation insurance.[93] This is true whether or not the farm is incorporated. But the owner of an unincorporated farm is not an "employee" even though he is operating the farm himself, and is therefore ineligible for the insurance.[94] By incorporating his farm, the owner can become an employee of the corporation and hence eligible for workmen's compensation insurance.[95]

88. Fair Labor Standards Act of 1938, § 13(a)(6), 52 Stat. 1060, as amended, 29 U.S.C. § 13(a)(6) (1952).

89. Agricultural labor is excluded from the Federal Unemployment Tax Act, 53 Stat. 1607(c)(1) (1939), as amended, 26 U.S.C. §§ 1607(c)(1), 1607(*l*) (1952). As to state statutes, see, *e.g.*, ILL. REV. STAT. c. 48, § 324 (1957); IOWA CODE § 96.19(7)(g)(4) (1958); MINN. STAT. § 268.04(12)(8)(a) (1957); N.Y. LABOR LAW § 511(6).

90. At least one and perhaps more Minnesota farm corporations were formed principally to obtain social security benefits for the owner.

91. 70 Stat. § 104(c)(2) (1956), 42 U.S.C. § 411 (Supp. V, 1958), repealed the provision excluding farmers from coverage.

92. LABOR LAW GROUP, THE EMPLOYMENT RELATION AND THE LAW 195 (1957). Reasons for this exclusion are given in 1 LARSON, WORKMEN'S COMPENSATION § 53.20 (1952).

93. See, *e.g.*, MINN. STAT. § 176.051 (1957);ORE. REV. STAT. § 656.090 (1957); WIS. STAT. § 102.05(3) (1957).

94. See generally 1 LARSON, WORKMEN'S COMPENSATION §§ 1.10, 43.00, 43.10 (1952).

95. See, *e.g.*, Corcoran v. P. G. Corcoran Co., 245 Minn. 258, 71 N.W.2d 787

Drawbacks of Corporate Organization

Certainly the major, if not the only, inherent *disadvantages* in the corporate form, aside from possible tax consequences, are the burdens of incorporation costs, statutory formalities governing the corporate operations, and dissolution costs.[96] Attorney fees and filing fees for incorporating a farm business will alone amount to several hundred dollars in most cases.[97] Even after the corporation is formed, it often must file annual financial reports, stock transfer reports, and reports on such things as change of officers, payments of salaries and other charges.[98] And if the corporation should be dissolved,

(1955); Goldmann v. Johanna Farms, Inc., 26 N.J. Super. 550, 98 A.2d 142 (Mercer County Ct. L. 1953). However, the incorporator should be warned that in some states he would be susceptible to an alter ego argument if he owns a high percentage of the stock. See 1 LARSON, WORKMEN'S COMPENSATION § 54.22 (1952).

Also, it is possible in some states for corporate officers to be insured in their capacity *as corporate officers*, as well as in their capacity as regular corporate employees. See, *e.g.*, Cosgriff v. Duluth Firemen's Relief Ass'n, 233 Minn. 233, 46 N.W.2d 250 (1951). However, 1 LARSON, WORKMEN'S COMPENSATION § 54.21 (1952) indicates that most states' statutes do not apply to corporate officers except when they are performing labor operations for the corporation rather than the duties of the office.

96. Existing corporation laws are geared toward the needs of corporations with a large number of stockholders and do not often take into account the special needs of the closely held corporation. See *Symposium — The Close Corporation*, 52 NW. U.L. REV. 345, 347–52 (1957). The following comment was made with regard to the Wisconsin corporation laws in considering their possible application to a farming enterprise:

> The paper work connected with incorporation and corporate operation is more than substantial for business [sic] with either a small staff or none at all. Articles of incorporation must be drafted, registered . . . and filed . . . any amendment must be recorded and filed; an annual report is required; changes in officials . . . and transfers of stock must be reported . . . an income tax return must be filed . . . and the payment of certain salaries, wages, rents and similar charges must be reported.

Note, 1952 WIS. L. REV. 171–72. Several farm incorporators in Minnesota, when interviewed, expressed the same view with regard to the formal requirements of the Minnesota statutes. However, one New York farm incorporator is reported to have said "that the extra bookkeeping he has to do pays for itself as an aid to good farm management." Smith, *op. cit. supra* note 76, at 16.

97. An Illinois farm incorporation bulletin lists the "total initial cost (not including professional fees) of incorporating a typical 200-acre Illinois cash-grain farm" to be $242.80. KRAUSZ & MANN, *op. cit. supra* note 81, at 9. (Emphasis added.) This sum includes a federal stamp tax of $118.80. See note 26 *supra*.

Fees, of course, vary from state to state. For example, the total cost of incorporating the same enterprise in Minnesota (again *excluding* professional services) would be approximately $354.80, or over $100 more than in Illinois. See MINN. STAT. §§ 300.49, 301.071, 357.18 (1957).

The method of calculating state fees also varies, *e.g.*, ALA. CODE ANN. tit. 10, § 6 (1940), provides a $1 fee for every $1000 of proposed capital stock; ARIZ. REV. STAT. ANN. § 10–104 (1956) provides a flat $25 fee for filing articles of incorporation and a $10 fee for issuing a certificate of incorporation; CAL. CORP. CODE ANN. § 124 (West 1955) provides a progressive schedule of fees ranging from $15 for capital stock under $25,000 to over $100 for capital stock over 1 million.

98. See Note, 1952 WIS. L. REV. 171–72. Of course the type and amount of reports that have to be filed vary from state to state. See, *e.g.*, MINN. STAT.

additional costs necessarily would be incurred.[99] Although these factors may be relatively minor for some farm businesses, they could be prohibitive for many owners of small farms.[100]

II. Antagonism Toward the Farm Corporation

One other point that could be significant in deciding whether or not to incorporate a particular farm business, aside from the advantages or disadvantages of the corporate form, is the prevalent mistrust, resentment and general antagonism toward corporate owned farms.[101] Whether or not this antagonism is justified, the attorney should be aware that it does exist in some areas, especially among farmers. A brief examination of some of the historical events behind the antagonism should prove helpful.

The antagonism is based principally on a fear that the agriculture industry could be swallowed up by large corporations, leaving no room for the familiar family farm.[102] Certainly two periods in history

§§ 301.25, .28, .34 (1957), dealing with shareholder and director meetings and with corporate books and records. Furthermore, filing of these reports and documents may not be free of cost. *E.g.*, Ariz. Rev. Stat. Ann. § 10–104 (1956) provides for a charge of $25 upon the filing of a required annual report.

99. In many states statutory dissolution fees may be small, *e.g.*, Ariz. Rev. Stat. Ann. § 10–104 (1956) provides for a $10 filing fee for a dissolution resolution, but often an attorney or a trustee is required, and their fees add substantially to this expense. See Minn. Stat. § 301.071 (1957).

100. See Note, 1952 Wis. L. Rev. 171, 172.

101. "There is the very real problem presented by the farmers' reluctance to have anything to do with something that smacks of corporate enterprise." Note, 1952 Wis. L. Rev. 171, 172. Many of the Minnesota farm incorporators interviewed were aware of some public resentment against farm corporations, mainly among farmers less successful in their enterprises than were the corporations. However, several of the incorporators doubted that antagonism was very prevalent against *local farmers* who decided to incorporate their own farms.

102. Ackerman & Harris, Family Farm Policy 42–43 (1947); Crossmon, *Research Into Mangement Problems of Corporate Farming*, 35 J. Farm Economics 953 (1953).

The purpose of this Note, however, is not to determine the merits or demerits of large and small farms, nor to determine which it should be the policy of this country to foster.

One Minnesota incorporator thought corporation farming got its bad name in the wheat areas of the plains states. Perhaps he had in mind the Kansas Wheat Farming Company, and similar mammoth farm corporations, operating in the late 1920's. The Kansas Company owned 65,000 acres of land in 1930, its peak year. This large scale farming (1931 harvest: 600,000 bushels of wheat, 200,000 bushels of barley, and 200,000 bushels of milo) "spelled mass production — industrialization of the farm! The golden age for agriculture had arrived." Turnbull, *Can Production Costs Be Cut By Corporation Farming?*, Implement & Tractor, 1946, No. 11, p. 45, 46. The public rebelled against this mass scale farming operation, and the Kansas legislature was finally pressured into requesting the state attorney general to bring an ouster action against the corporation; the ouster action was successful. State v. Wheat Farming Co., 137 Kan. 697, 22 P.2d 1093 (1933).

A law prohibiting certain agricultural corporations, enacted at the same time the

have contributed greatly to this fear. During the period climaxing in the late 1800's in which the rural regions of America were being settled, many companies were involved in land speculation. A picturesque description of the situation during this land speculation era is offered by William Allen White:

> The history of this century and a half is full of national scandals. . . . Every state has its crooked land company. The school lands in many of the states were sold for a few cents an acre. The public lands were looted by corporations that hired men to take up bogus claims and sell them to organized promoters who in turn swindled investors.[103]

Again, during the 1929 depression years many farms were seized through mortgage foreclosures by loan and investment companies.[104] Land ownership surveys of that period, however, give no indication of voluntarily formed farm corporations, but only of farm holdings by other business corporations.[105] Nevertheless, this large scale invasion of family farms by corporate organizations contributed little to a welcome reception for the farm corporation.

In comparing these historical situations with today's trend toward voluntarily incorporated farm businesses, it should be remembered

---

ouster was requested, still prohibits the formation of major agricultural corporations in Kansas. KAN. GEN. STAT. ANN. § 17-202a (1949).

103. WHITE, THE CHANGING WEST 39-40 (1939). Legislation was passed in this period (1890-1900) prohibiting certain corporations from acquiring or holding more than a specified amount of land. See, *e.g.*, Minn. Laws 1895, ch. 175, § 75 (insurance company); Minn. Laws 1887, ch. 204, § 3 (limiting corporations generally from acquiring more than 5,000 acres of land).

Tex. Laws 1893, ch. 38, § 2, provided:

> [N]o private corporation heretofore or hereafter chartered or created whose main purpose of business is the acquisition or ownership of land by purchase, lease, or otherwise, shall hereafter be permitted to acquire any land within this State by purchase, lease, or otherwise.

But although this law is still on the books (See TEX. REV. CIV. STAT. ANN. art. 1362 (1945)), it does not prohibit corporate farming. See Kirby v. Pitchfork Land & Cattle Co., 129 S.W. 1151, 1152 (Tex. Civ. App. 1910).

104. TIMMONS & BARLOWE, FARM OWNERSHIP IN THE MIDWEST 858 (North Central Regional Pub. No. 13, 1949).

105. See, *e.g.*, *id.* at 858-59 (a survey of farm land ownership in the North Central Region, consisting of Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin). Loan and investment companies held two-thirds of the land owned by corporations. The remaining one-third "was owned by land and realty companies, industrial owners, churches, private colleges, fraternal organizations, charitable institutions and a group of miscellaneous and unclassified owners." *Id.* at 859. The break-down of all land ownership was as follows: individuals 94%, public agencies 3%, corporate and private institutional owners 2%, and 0.5% by formally organized partnerships. *Id.* at 856-57. See also DOWELL, CORPORATE-OWNED FARM LAND IN MINNESOTA, 1936-1940, at 10 (University of Minnesota Agricultural Experiment Station Bull. 357, 1942). Out of 10.36% total farm land held by corporations in Minnesota in 1938, insurance companies held 3.58%, the Minnesota Department of Rural Credit held 2.15% and trust and mortgage investment companies held 1.10%.

that many of today's farmers are just *ordinary family farmers* who, instead of using the sole proprietorship or partnership form of organization, want to operate as corporations.[106]

III. CAVEAT

This Note was intended only to raise the considerations that should *in no case* be overlooked when deciding whether or not to incorporate a farm business, and to discuss them extensively enough to give a general understanding of the problems as well as the advantages they present, rather than to treat any of those considerations exhaustively.

106. "Actually, encouragement of family farm corporations will in no way endanger the family farm system. With the stock ownership limited to family members engaged in operating the farm, incorporation would merely serve to change the business organization of the family farm." Smith, Incorporation of the Farm Business 10–11 (Department of Agricultural Economics, Cornell University Agricultural Experiment Station, A.E. 831, 1953).