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A Closer Look at Iowa Farm Corporations

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A year ago, we outlined the possibilities and the advantages and disadvantages of incorporating family farms in Iowa. This article reports some additional findings of a study of existing farm corporations in the state.

by Neil E. Harl, John C. O'Byrne and John F. Timmons

INCREASING numbers of Iowa farms have turned to the corporate form of business. State records show a substantial recent increase in farm incorporations.

We reported on the general principles, possibilities and the advantages and disadvantages of incorporating family farms in the July 1959 issue of IOWA FARM SCIENCE. (See "Incorporate the Family Farm?" in that issue or reprint FS-820.) We pointed out that the main question in deciding whether or not to incorporate is whether or not the corporate form of business offers a better tool than the present form for a particular farm business.

Because of the increased interest in farm incorporation, we began a long-term study of farm incorporations in 1958. The study is a cooperative one between the Agricultural Law Center of the State University of Iowa, the USDA and the Agricultural and Home Economics Experiment Station here at Iowa State. A part of this study involves a detailed look at some of the existing farm corporations in Iowa. This article reports some of the preliminary findings of this part of the study.

We believe that certain of the findings will be of general interest. These include: the sizes and types of farm operations that have been incorporated; how they're owned and managed; the costs of incorporation; difficulties encountered; and some of the reasons for incorporating. We asked questions about these and other aspects of the shareholders of 20 Iowa farm corporations selected at random throughout the state.

All "Closely Held" . . .

All of the corporations in our study were found to be "closely held." Stock in each case was owned by a small group and not available for public purchase. Provisions in the articles of incorporation, by-laws or separate shareholders' agreements of many of the corporations restricted the transfer of stock among "outsiders." Shareholders in 19 of the 20 corporations were related by blood or marriage. Shareholders in the other corporation were business associates in a separate nonfarm business.

Operating Arrangements

Seven of the 20 were "operating" farm corporations. The corporations owned all assets used in the business—except, in some cases, the land. In one of these cases, all land was rented to the corporation by the majority shareholder. In the others, part of the land used in the business was owned by the corporation, and part was rented to the corporation.

Nine of the corporations were "landlords"—renting land to tenants, usually on a crop or livestock share lease. Most of the shareholders were off-farm residents who followed off-farm vocations. Some of the shareholders had obtained their interests by purchase. But most had inherited the land from parents who had formerly operated the farm. The shareholders had income from their off-farm jobs and weren't particularly interested in obtaining regular income from the farm business. So most of the landlord corporations had accu-

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mulated earnings over the years. Generally, only a small part of the corporation earnings had been paid out to the shareholders in the form of salaries or dividends.

The remaining four corporations were combinations of various operating arrangements. One was a landlord and also a partner in a farm business. The other three operated part of the land and rented the rest to tenants.

Size of Business . . .

Land holdings of the 20 farm corporations ranged from 160 to almost 3,000 acres. Six involved 1,000 acres or more, and six had 500 acres or less. These acreages represent the total in the farm business, whether owned by the corporation or rented to the corporation by others.

Average size of the operating corporations was somewhat larger than the landlord corporations. The operating corporations managed an average of 846 acres; the incorporated landlord operations averaged 523 acres. The larger size of the farm operating corporations probably is due to many factors. Four of the seven operating corporations were managed by second-generation members of the same families, and the businesses have gradually increased in size. Landlord corporations, with a large proportion of off-farm shareholders, tended to leave most of the earnings in the corporations but generally hadn't used the earnings to increase land holdings.

How Owned?

The number of shareholders per corporation ranged from two to 13. The average was roughly four per corporation for both the operating and landlord corporations.

One farm corporation was owned entirely by a family partnership with many partners, including a trust for minor children. In another, part of the stock was held by trusts set up for grandchildren under the grandparents' wills. But in 18 of the corporations, all shareholders were individuals.

In four of the seven operating corporations, all shareholders were corporation employees and devoted all of their time to the business. In one, all shareholders lived off the farm and devoted most of their time to off-farm jobs; the farm business was carried on by hired labor. In another case, four of the five shareholders were engaged in off-farm occupations; the fifth, a brother, managed the farm business. In still another, one of two shareholders in the corporation was also farming for himself.

In six of the nine landlord corporations, all shareholders worked full time in off-farm jobs. In the other three, part of the shareholders worked off the farm, but one or more of the shareholders was closely connected with the farm business. In one of these cases, a retired farm operator who lived in town and owned stock in the corporation devoted considerable time to managing the landlord corporation. In another, the tenant's wife was a shareholder in the corporation. In the third case, the operator who rented land from the corporation was a shareholder.

Businessmen made up the largest group of off-farm shareholders. They and their wives comprised more than 27 percent of all off-farm shareholders. Ranking next were children under 21 (17 percent of all off-farm shareholders) whose parents were employed off the farm. Farm people who farmed independently for themselves made up almost 11 percent of the "off-farm" shareholders.

Retired farm operators and wives of retired farm operators made up slightly less than 10 percent of the off-farm shareholders. Physicians and wives of physicians also accounted for about 10 percent. Industrial workers, lawyers, bankers, engineers, chemists, students over 21, teachers, etc. made up the remaining 25 percent of off-farm shareholders.

Off-farm shareholders (those devoting the main part of their time to some other job than working for the corporation) owned an average of 33 percent of the stock of the operating corporations. The comparable figure for landlord corporations was about 82 percent.

How Managed?

The characteristic corporate split—among shareholders, the board of directors and officers—in management rights and responsibilities had little practical significance in these Iowa corporations. The stock was closely held, and few people were involved in corporate management. The rights and responsibilities of the three groups merged, and each of the farm businesses was managed in much the same way as before incorporation.

In 15 of the 20 farm corporations, all shareholders were also members of the board of directors. In 11, all shareholders were also officers of the corporation. Here, the three management groups were identical in membership.

Very little attention was given to which management group should make certain decisions. Decision-making usually was informal, though major decisions such as land transactions, salaries, etc. were recorded in the minutes of the meetings.

Policy-making and day-to-day management rested largely with the owners. All of the directors were shareholders in 17 of the 20 corporations. In two, the attorney for the corporation served as a director but wasn't a shareholder. In the other, shareholders' wives, who owned no stock in their own names, were on the board of directors. All officers were also directors in all 20 corporations. In 19 of the 20, the officers were all shareholders.

Nearly all management decisions were made by only a few people in most of the farm corporations. In all but two cases, the decision-makers were officers, and one of them usually was the president. In one instance, however, the decision-maker was a general manager who owned no stock, but he was a member of the family that owned all of the stock. In another case, farm management decisions were made by the husband of one of the shareholders; he was also a tenant on one of the farms owned by the corporation.

The decision-makers, on the average, were older than the other shareholders. The average age of all "managers" was 52, while nonmanaging shareholders averaged 45 years of age (all shareholders under 21 omitted).

Why Incorporate?

Shareholders listed a number of reasons for their decisions to incorporate. Most of the reasons were based on or related to the relative advantages and disadvantages discussed in our first article (see July 1959 issue or reprint FS-820).

Ease of transferring property was the most frequently mentioned reason, though not always the most important one in each case. Easier continuation of the business after death of the original owners was the second most frequently listed reason. Income tax advantages ranked third, with limited liability, access to capital and retirement planning, following in that order. The relative importance of each of these factors varied according to each situation.

One corporation was organized partly to consolidate three separate units of the family farm business. Another incorporator wanted to divide legal ownership for death tax savings but retain the balance of control. One corporation mentioned the businesslike atmosphere created as the main reason for incorporating. In another case, a shareholder mentioned the ease of sharing income and expenses proportionately as a reason for incorporating. A mutually agreeable sharing of expense and income is a major economic problem with many multiple-ownership operations.

Double taxation of corporate earnings often is mentioned as a drawback for small business corporations. Earnings paid out as dividends are taxed to the corporation when earned and again to the shareholder when received. But this wasn't a major problem for these 20 Iowa farm corporations. Only one declares dividends to shareholders. Shareholder-employee salaries, interest on money loaned to the corporation by shareholders and rental on land rented to the corporation by shareholders are expenses of doing business and are tax deductible to the corporation.

Shareholders in five of the corporations rented land to the corporation. Shareholders in eight of the corporations loaned money to the corporation. In 13, part or all of the owners received a salary.

Costs of Incorporating . . .

Total costs of incorporation were available for only 13 of the 20 corporations. For 12 the average cost of incorporation was $471 per corporation. Of this, the average attorney fee was $257. (The one corporation not included in the average had a much higher cost of incorporation because of its complex situation.)

Besides attorney fees, the main expenses were fees to appraisers for the Iowa Executive Council, fees paid to the Secretary of State, the cost of recording the articles of incorporation in the county recorder's office, the cost of publishing the notice of incorporation in a county newspaper, the federal stock stamp tax, minute books, stock certificates and a seal (not required by law).

These farms were incorporated before the new Iowa Business Corporation Act became effective July 4, 1959. Costs of incorporation now should be lower. Publication of the notice of incorporation has been reduced from four times to only one, and the Iowa Executive Council need no longer appraise assets transferred to the corporation. The organization fees payable to the Secretary of State have been lowered, but the annual fees payable have been increased under the 1959 law.

Satisfaction . . .

The shareholders interviewed of 19 of the 20 incorporated farms were pleased with the decision to incorporate. The dissatisfactions of the shareholders of the other corporation didn't stem from the corporation itself. The dissatisfaction stemmed from the inability of the shareholders—all of whom lived off the farm—to manage the farm business effectively. This also was the only farm corporation of the 20 in which the shareholders weren't related.

None of the corporations had experienced legal difficulty except from income tax audits and one instance in which corporate property had been stolen.

Many of the farms that have operated succcessfully as a corporation are typical family farm operations.

In General . . .

The findings of this study indicate that the corporate form of business has been used as a tool to achieve a number of different purposes with generally satisfactory results. This, in turn, indicates wider potential application of the corporate form to Iowa farm businesses — depending on individual need and situation.

The decision as to whether or not to incorporate calls for a balancing of advantages to be gained against disadvantages involved. And, as emphasized in our first article, the main question is whether or not the corporate form of business is a better tool than the present form for a particular farm business.