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Neil E. Harl
Iowa State University

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Corporate Divisions: Often A Last Resort
For Farm and Ranch Families

-by Neil E. Harl*

For those who chose the corporate route, often years ago, and friction has developed between on-farm and off-farm heirs (or just among on-farm heirs), a corporate reorganization may be an acceptable route to a fair and acceptable solution.¹

Keep in mind that there are three patterns of non-taxable corporate divisions which are recognized although those patterns are not all fully recognized in statutory law. The most widely used is the “spin-off” which involves a distribution by a parent corporation of corporate assets to a newly formed corporate subsidiary in a tax-free exchange for some shareholders of the parent corporation and retention of assets in the parent corporation to achieve an agreed upon pattern of ownership between or among the original shareholders.² Note that the “spin-off” does not result in any of the original shareholders being shifted to non-corporate status but it does leave unhappy shareholders in their own, in some cases, newly formed, corporate entity.

Three steps in a divisive reorganization

A corporate division in a “spin-off” involves three major steps which must be taken as prescribed-

(1) Formation of a new corporation (or corporations) by the parent corporation as needed (in one recent instance, one of the unhappy shareholders of the parent corporation took the initiative and that caused the process to be halted – the new corporation or corporations must be set up by the parent corporation inasmuch as the process involves a tax-free splitting up of the assets);

(2) Transfer of part of the parent corporation’s assets to the subsidiary (or subsidiaries) and part remain with the parent corporation, as agreed to by negotiations between or among the shareholders of the parent corporation; and

(3) For those who are planning to end up with an exchange of their stock (and underlying assets) in the parent corporation for stock in a subsidiary, that is achieved by exchanges of stock. The result – each shareholder ends up with sole ownership of their stock in a corporation holding their chosen assets except for the shareholder who has agreed to accept sole ownership of the remaining ownership of the parent corporation.

* Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.
For a divisive reorganization to be tax-free (except for “boot”), five tests must be met:

1. The subsidiary corporation (or corporations) must be controlled immediately before the distribution by the parent corporation. At least 80 percent of the shares of all classes of stock must have been acquired before the five-year period begins to run.

2. The necessary “trade or business” must have been actively conducted for five or more years before the distribution by the parent corporation. Immediately after the distribution, both the parent corporation and the subsidiary (or subsidiaries) must be engaged in the “active conduct of a trade or business,” or immediately before the distribution, the distributing corporation had no assets other than stock or securities in the controlled corporations and each of the controlled corporations is engaged immediately after the distributions in the “active conduct of a trade or business.”

3. The corporation making the distribution must have stock or securities in the other corporation or corporations so that the persons who were shareholders in the parent corporation control the subsidiary.

4. The parent corporation must distribute (a) all of its stock and securities in the subsidiary, or (b) enough stock to constitute control and establish to the satisfaction of IRS that the retention of stock and securities in the subsidiary was not part of a plan of tax avoidance.

5. The distribution must not be used “principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both ...”

Reorganization motivated by a “business purpose”

This is the most worrisome requirement for a corporate reorganization. A distribution must be motivated, in whole or substantial part, by one or more corporate business purposes. As the regulations state, “the principal reason for this business purpose requirement is to provide nonrecognition treatment only to distributions that are incident to readjustments of corporate structures required by business exigencies and that effect only readjustments of continuing interests under modified corporate forms.”

For farm and ranch situations, the greatest concern is where the line is drawn for rental properties, notably crop share, livestock share and cash rental arrangements. In an early ruling, a crop share lease met the test. However, in a 1986 ruling a “hybrid” crop share lease failed the test because of absence of involvement in management. In a farming operation that likely would have qualified before the retirement of the managers and principal decision makers, it failed to qualify after the management duties were largely turned over to the tenant. This aspect of the “business purpose” test is arguably more demanding than similar fact situations in non-farm situations where entities rarely are operated under arrangements similar to farm arrangements.

END NOTES

2. Id.
5. I.R.C. § 355(a).
12. Id.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ANIMALS

HORSES. The plaintiff was injured while riding a horse owned by one defendant at a resort owned by another defendant. The defendant’s horse spooked during a trail ride and the plaintiff was thrown from the horse and injured. The plaintiff sued in negligence, negligence per se and willful, wanton and malicious conduct. The defendant resort owner moved for summary judgment based on the Wisconsin equine immunity statute, Wis. Stat. § 895.481, which provides “a person, including an equine activity sponsor or an equine professional, is immune from civil liability for acts or omissions related to his or her participation in equine activities if a person participating in the equine activity is injured or killed as the result of an inherent risk of equine activities.” The statute provides exceptions where the sponsor “(a) Provides equipment or tack that he or she knew or should have known was faulty and the faulty equipment or tack causes the injury or death. (b) Provides an equine to a person and fails to make a reasonable effort to determine the ability of the person to engage safely in an equine activity or to safely manage the particular equine provided based on the person’s representations of his or her ability. (c) Fails to conspicuously post warning signs of a dangerous or insignificant condition known to him or her on the property that he or she owns, leases, rents or is otherwise in lawful control of or possession. (d) Acts in a willful or wanton disregard for the safety of the person. (e) Intentionally causes the injury or death.” The plaintiff argued that the plaintiff was not covered by the statute because the accident...