Partnerships and Corporations in Family Farming

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Partnerships and Corporations in Family Farming

Can corporations be used to protect the family farm? Before 1958, the answer seemed to be "no." The main reason was thought to be double taxation of corporate profits—once when earned by the corporation and once again when the profits were distributed to stockholders.

But in 1958, the Internal Revenue Service adopted a rule which allows certain small corporations to be taxed as partnerships. This removed a major obstacle to farm corporations. Since then, farmers can incorporate to provide for retirement plans, sick pay arrangements, stock purchase or stock redemption plans, limited liability, transfer of ownership to heirs and so on.

Family Farms are Tough

In February 1976, the office of Secretary of State reported 466 family farm corporations in South Dakota as compared to 23 before 1958. This is an average increase of 26 per year. Since the 1969 census, the increase has averaged 34 per year.

Why so slow an increase? Apparently double taxation is not the only reason why there are few farm corporations. The usual single-family farms must have important advantages. Otherwise after 18 years there would be many more farm corporations.

Some people also believe farm partnerships have much to offer. Some agricultural economists have argued that because farm landlords share crops with their tenants they should share all operating costs in the same way. Thus the share rent lease would be converted into a "perfect partnership." But landlords and tenants have both rejected this idea.

Farmers have always had full freedom to create partnerships. Yet in South Dakota only 12 percent of all farms are partnerships. Most of these are father-son partnerships. Why so few partnerships? They, too, must have important disadvantages as compared to single-family farms.

Farm Organizations Compared

Here's a comparison of the three kinds of farm organizations in South Dakota reported by the 1969 U.S. Census of Agriculture -- the latest comparison available:

<table>
<thead>
<tr>
<th>Number of farms</th>
<th>Percent of farms</th>
<th>Land, mi. of acres</th>
<th>Percent of land</th>
<th>Acres per farm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single family</td>
<td>35,149</td>
<td>87</td>
<td>31</td>
<td>894</td>
</tr>
<tr>
<td>Partnership</td>
<td>4,850</td>
<td>12</td>
<td>6</td>
<td>1,315</td>
</tr>
<tr>
<td>Corp.</td>
<td>262</td>
<td>1</td>
<td>2</td>
<td>5,549</td>
</tr>
</tbody>
</table>

These figures are for commercial farms enumerated by the 1969 census. Corporations represented less than 1 percent of all commercial farms but operated 4 percent of all farm and grazing land. Corporate farms are larger in part because many of them are ranches that require many acres for an economic unit. Presently, with 466 corporations there is slightly more than 1 percent engaged in farming.

Problems of Partnerships

Why are farm partnerships so few? Why not have two steering wheels on a tractor? The answers to these two questions are much the same. Partnerships...
work best when one partner is the "boss" and makes the final decision. Sometimes one partner makes the final decision on crop enterprises and the other on livestock. But this also has its problems because what one partner does affects the income of the other.

If the farm is large enough to support two families -- why not divide it? This often happens. Some fathers have found this is the best way to get a son or son -in- law started farming. Both have their own farms and livestock, but they trade help and machinery when needed. Sometimes they own a combine or other large machinery in partnership -- but that's all.

Problems of Family Corporations

Some partnerships may be tempted to incorporate to limit liability only to find that one or more of the stockholders may be held personally liable. They may also feel that it will improve the management. However, farm corporations need only one steering wheel, too. They may work reasonably well as long as the father is alive and active as "boss." After that corporations become, in effect, unsettled estates in which the whole family may be locked into the farm business. Thus the operating heir may find that he is the "hired man" to run the farm as directed not by his father but by his mother, brothers and sisters. This situation may be much worse than the usual father-son partnership.

One solution to this problem may be for the corporation to lease the land to the operator. Even here a share rent can be troublesome -- too many "landlords." A solution in some instances is to use a fixed cash rent, a fixed produce rent, or a flexible cash rent. But any corporation that receives 20 percent or more of its income as rent will be subject to double taxation.

Because family farms are now so large there is need for better tenure arrangements. Perhaps what is needed is a cooperative that can hold and lease land under conditions that give the farmer most of the security and freedom of owner-operators. Neither partnerships nor family corporations are fully able to meet this need.

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