THE MISSISSIPPI CHRISTMAS TREE

by Winston I. Smart

For the uninitiated, the Mississippi Christmas Tree (MCT) is an elaborate and carefully designed business structure which is used to clothe a farming operation that seeks to maximize its receipts from certain commodity programs. Federal law limits payments to participants in certain farm programs to $50,000. However, with some corporate and financial planning, it is possible to avoid this limitation.

On the advice of any attorney familiar with the MCT and with the help of an accountant to balance the figures accordingly, a farmer may obtain as much as $300,000 or six times the legal limit on his program payments. This brief article shows how it can be done, discusses the fate of previous MCT arrangements under the recent (1988) payment limitation rules, and suggests ways to limit opportunities for MCT arrangements in the future.

Important Concepts

Any discussion of the MCT must begin with a brief survey of the most relevant payment limitation rules, concepts and definitions. The most important is the 'person' which includes an individual and a corporation, but not a general partnership. To be eligible to receive payments with respect to a particular farming operation, a person must be "actively engaged in farming" with respect to that operation.

"Actively engaged in farming" is specifically defined for individuals and corporations. To qualify, an individual must make a specifically defined "significant contribution" of land, capital, equipment and/or land, as well as a "significant contribution" of active personal labor and/or active personal management. Adult family members, however, need provide only a "significant contribution" of active personal labor and/or active personal management. They need not contribute land, capital or equipment to qualify as eligible persons.

Family members include any individual to whom another member in the farming operations is related as lineal ancestor, lineal descendant or sibling, as well as spouses of those family members who do not make a "significant contribution" to the farming operation. Much to the chagrin of farm spouses who hunger for the fruits of the Christmas Tree, husband and wife are considered one person unless they maintain separate and distinct farming operations before and after marriage. This particular rule has withstood a constitutional challenge in federal court from a group named W.I.F.E (Women Involved in Farm Economics) and Congress has chosen to let it stand.

A corporation is deemed to be "actively engaged in farming," with respect to a farming operation, if it makes a "significant contribution" of capital, equipment and/or land, and its shareholders make a "significant contribution" of active personal labor and/or active personal management.

An individual may receive program payments from a farming operation conducted by himself and not more than two "permitted entities" (such as corporations) in which he owns a substantial beneficial interest. As an alternative, an individual may receive program payments from no more than three "permitted entities." If the same two or more individuals own more than 50 percent of the interest in two or more corporations, then such corporations are deemed to be one "person."

A Possible MCT

Let us now consider one possible Christmas Tree arrangement. Let us take the simple case of a farmer, F, who has a son, S, and a daughter, D. F owns the farm and is limited to a payment of $50,000 if he runs the farming operation as a sole proprietorship. The objective is to create a structure for the farming operation that will increase the number of eligible persons. Here is where the attorney and the accountant are called in.

The first step is to have F, S and D form three corporations. FS, Inc. has two equal shareholders, F and S. Similarly, FD, Inc. has two equal shareholders, F and D, and SD, Inc. has two equal shareholders, S and D. The second step is to form a general partnership, FSD Partners, which has six general partners, namely F, S, D, and the three corporations. The partnership itself cannot qualify for a payment, but each of its six partners can. The third step is to observe the corporate formalities and to do so in a manner consistent with the payment limitation rules.

Let us consider the eligibility of each of the six partners. F should qualify easily. If he owns or leases some or all of the land or the equipment and provides some of the capital and contributes labor and management, as most farmers do, he will qualify. S and D, as family members, need only provide active personal labor and/or active personal management to qualify. This can easily be arranged. Three down, three to go.

Since the shareholders are already contributing active personal labor and/or active personal management to the farming operation, each corporation merely has to make a "significant contribution" of land, capital and/or equipment. It may lease land from the farmer himself or from another person and contribute it to the partnership. Each shareholder may borrow money and contribute it to the corporation or the corporation may borrow money in its own name. Such funds are then contributed to the partnership. Or, each corporation may buy equipment on a security agreement with a small down payment and contribute that equipment to the partnership.

Each shareholder has to participate in the business affairs of the corporations so as to create an impression that he or she is a genuine shareholder. Hence, they must negotiate agreements together, sign documents together and make all decisions for the corporation jointly. The precise amount of the contribution of each partner, shareholder, or corporation must be carefully calculated by the attorney and the accountant to ensure that they stay
within the parameters or specifics of the rules. But it should not be too difficult to qualify all three corporations.

The farming operation will now be eligible to receive six payments instead of one, $300,000 instead of $50,000. If the farmer has more family members who are willing to join the operation, then the total payment might be greater.

The Mississippi Christmas Tree lives on in spite of new rules adopted in 1988 to curb it. One questions whether the MCT lives on because of rules adopted to curb it. There are those who claim that the USDA condones the MCT because most farm operations would fail without its protective cover. There appears to be some support for this view considering the fate of the MCT arrangements under the pre-1988 rules and upon examination of certain rules themselves.

Pre-1989 MCT Arrangements

Under the current rules, the pre-1989 MCT arrangements are void unless they conform to the 1988 rules. Since the whole purpose of an MCT is to attract a certain quantum of federal dollars and not simply to create an elaborate business structure, farmers whose MCT's were voided by the rule changes were expected to restructure their operations to make them conform to the new rules. Only by so doing would they collect the same amount of federal dollars.

The "new" regulations did not prevent such restructuring. It prohibited a restructuring only if it increased the number of eligible persons and it was not "bona fide and substantive." Further, in cases where the application of the new rules would have led to reduced payments, the ASCS gave itself discretionary power to waive the requirement that changes in farming operations, which increased the number of eligible persons, be bona fide and substantive. Believe it or not, the stated purpose of this self-grant of discretion was to facilitate "equitable reorganizations that do not result in an increase in payments." Hence, a couple of recommendations are in order. What if the rules were to limit the ultimate amount received by each individual to a fixed sum, regardless of the elaborateness of the structure of the farming operation? This sum might be termed the "effective dollar limit" as opposed to the maximum payment per eligible person. Hence, an individual who is actively engaged in farming would receive the "effective dollar limit" of $50,000, or whatever sum Congress selects, regardless of whether he is a shareholder in zero or ten corporations. To limit an individual to one payment plus half shares in the payments to two corporations is simply a disingenuous way of doubling the congressionally mandated payment limit. It does not take a mathematician to figure out that one whole plus two halves equals two. If an "effective dollar limit" is imposed on each individual, then the incentive to create elaborate phony structures will immediately disappear.

Finally, one cannot ignore that the rules clearly anticipate and sanction double counting of contributions by family members who are shareholders. Under the rules, family members do not have to make a "significant contribution" of land, capital and/or equipment to qualify as eligible persons. The contribution by the primary individual, F, suffices. In the example above, the effect of this rule is to add two eligible persons.

Likewise, corporations do not have to make a separate "significant contribution" of active personal labor and/or active personal management if their shareholders do. In the example, the effect of this rule is to add three more eligible persons. The total effect of allowing double counting is the addition of five eligible persons. And this is precisely the purpose of setting up the Mississippi Christmas Tree. The elimination of the privilege of double counting of contributions would go a long way towards the prevention of MCT abuses.

For the record, the USDA might complain about the difficulty of policing program abuses or point to the need to put resources into food stamp abuse prevention. Such a response might be answered by one question. How would the USDA respond if food stamp recipients were routinely using a known scheme to obtain as much as six times their entitlement?

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