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Minnesota Agricultural Economist
No. 680 Spring 1995
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A New Look at Farm Business Organization
Dale C. Dahl

While Minnesota farm numbers decreased in recent decades, the business organization of those remaining has changed, reflecting the complexities of modern agriculture. Earlier University researchers reported ninety farm corporations in Minnesota in 1938-9. By 1992, nearly two thousand farm business corporations were located in all but one of the state's 87 counties (see Figure 1).

The most common forms of farm business organization remain the sole proprietorship, the partnership, and the corporation. But over the past three centuries, other legal forms have been applied in agricultural settings. For example, the general partnership has been supplemented by the use of the limited partnership. The standard "C" corporation now has a subchapter "S" variant commonly employed in farm situations. Other business types have become part of current agricultural discussion: joint ventures, limited liability companies, and limited liability partnerships.

In this article, I summarize features of various legal forms of business organization used in agriculture and present recent data regarding economic characteristics of some of these farm business types.

Traditional Forms
Several factors influence a farmer's selection of one type of business organization over another. These include simplicity, continuity, liability of owners, tax consequences, estate transfer concerns, and acquisition of capital. The sole proprietorship has always been and is likely to remain the most common form of farm business organization in Minnesota, because it is the most simple to understand and use. In effect, an individual merely declares himself as a business. The person owns, funds, and operates the business, reports its income and expenses, and accepts liability for any problems. The business income tax return is a part of the owner's personal income tax return.

A principal disadvantage of the sole proprietorship is that the ability to raise capital is limited to the reputation and net worth of the owner. Also, the business goes out of existence or becomes legally incapacitated upon the owner's death. There is no continuity. (See Farm Business page 2)

The Geography of Minnesota Crops
Jeffrey Apland and Yongsung Cho

As part of our development of an agricultural sector model for the state, we conducted a statistical analysis of county-level crop data. Location is important for sector modeling in two fundamental ways. First, spatial differences in supply and demand, along with transportation costs, ultimately determine the pattern and volume of trade and prices. Second, differences in crop mix and crop yields are important in characterizing the production capacities and alternatives of farms in various regions. In this report the focus is on the second rationale: We measure production levels by comparing counties according to the proportion of cropland devoted to a particular crop. This gives us an indicator of the intensity of production. We measure productivity by average crop yields over a five-year period. Although our analysis actually

(See Geography page 5)
In farming, two somewhat distinct types of limited partnerships have arisen. Family, or closely-held, limited partnerships serve a number of objectives. Parents contemplating retirement may wish to maintain their investment in a farm business, but limit their liability and be free of management concerns. To accomplish this, the parents can be limited partners in a business where younger family members are the general partners. Acquisition of debt capital for a family or closely-held limited partnership is not much different than for a sole proprietorship. The lender may have a greater interest in the former if there is an expanded equity capital base.

Large-scale limited partnerships in agriculture provide tax shelters for the limited partners and generate tax shelters and profits for the general partners, commonly called equity partners. The general partner normally provides only a small portion of the equity capital. In return for organizing and managing the partnership, the general partner normally gets an initial lump-sum management fee and a continuing management fee based upon the gross income of the business. The joint venture is another variation of the partnership, usually more narrow in function and duration. A partnership under the law of partnership applies to joint ventures. The primary purpose of this form of organization is to share the risks and profits of a specific business undertaking.

Corporations

Three fundamental characteristics distinguish corporations from partnerships and proprietorships: (1) the way they are owned and managed, (2) their perpetual life, and (3) their status as legal entities separate from their owners and managers. Corporations issue ownership shares in the form of common stock. The owners of this stock vote to elect a board of directors to manage the corporation for the shareholders. The corporation is not dissolved on the death of the owners. A corporation is a separate legal entity that can own property, sue and be sued, enter into contracts to buy and sell, and all — in all its own name. The owners usually cannot be made to pay any debts of the corporation. Their liability is limited to the amount of money they have paid or promised to pay into the corporation.

New Business Forms

Minnesota adopted a limited liability company (LLC) statute in 1992 to encourage another general partnership in organization option. The owners of an LLC are called "members," with (theoretically) no personal liability for the obligations of the LLC. However, like a partnership, a properly constituted LLC can be taxed like a partnership under federal income tax law. No federal tax, and, presumably, no state tax, will be imposed on the LLC itself. The members include any income or loss on their own tax returns.

The affairs and conduct of the LLC business are governed by an operating agreement among its members. Ownership is represented by member interest. Management of an LLC may be vested in the majority (or other) members in proportion to their membership interests; however, the operating agreement may provide for the selection of managers by the members. The managers do not have to be members, or like members, they have no personal liabilities for the obligations of the LLC.

The LLC may be dissolved by the occurrence of certain events such as expiration of a period fixed in the operating agreement, withdrawal of all members, or death of a member. In 1994, Minnesota created the limited liability partnership (LLP), similar to a general partnership except that the partners are shielded from personal liability. LLPs constitute a revolution in the law of partnerships. Until now, the hallmark of a general partnership has always been the partners’ automatic liability for all of the partnership’s debts. Liability exists merely on account of their status as a partner, not because they have personally done anything to create or guarantee the obligation. Minnesota’s LLP amendments provide a safe harbor for general partners to escape this "vicarious" liability. A general partnership can obtain LLP status by filing an annual registration with the secretary of state.

LLP status is available to newly-formed and previously-existing general partnerships. General partnerships may wish to consider registering as an LLP or to convert to an LLC. Because these forms are new, it is wise to proceed carefully in adopting either of them. Selection of a legal form of business by owners of farms or agribusinesses must be a strategy to protect one's estate and involves consideration of possible legal liabilities, tax consequences, and operational management.

Most individual farmers nevertheless may decide to continue as sole proprietors. In many situations, alternatives to this basic business form are evaluated only when transfer of the farm to a new generation becomes necessary. While parent-child partnerships remain frequently-used and time-tested vehicle, new alternative forms are now available that may be advantageous to the farmer. In this manner, the features of these alternative forms are listed in Table 1. Each situation is sufficiently unique to call for the counsel of an attorney and tax advisor.

Who’s Doing What?

The Centers of Agriculture lists five categories of farm business organizations in its statistical compilation: sole proprietorships, partnerships (includes limited partnerships), family corporations, other corporations, and other forms (such as agricultural trusts, estates, trusts, institutional entities). As indicated in Figure 2, nearly 86 percent of the farms in the nation were organized as sole proprietorships in 1992. Close to ten percent of U.S. farms are partnerships, followed in relative rank by farm family corporations at 3.3 percent. Non-family corporations account for less than one-half of one percent of the nation’s farms and only 1.3 percent of agricultural acreages. In general, sole proprietorships have fewer acres per farm than partnerships, and partnerships are smaller in size than corporations.

Minnesota’s number and size proportions are similar to the national averages, but non-family corporations and other legal forms are less important, perhaps due to the existence of the state’s corporate farm law (which prohibits certain corporate, and limited liability entities from owning land or engaging in farm production). California tends to have partnerships that account for a disproportionate share of the state’s farm land. Most Midwest states are similar to the U.S. in general patterns.

In Minnesota, the proportions of farms identified as sole proprietorship and partnerships have remained stable from 1982 to 1982 even though the absolute number of farms has decreased (statistically). Table 2). Sole proprietorships have made up around 88 percent of the state’s farms even though the number declined by more than twenty percent in this ten-year period. A slight decline in the number of farm partnerships during the decade is offset by a relative increase in farm corporations. It should be stressed that only family

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Table 1. Selected Features of Alternative Farm Business Organizations

<table>
<thead>
<tr>
<th>Type</th>
<th>Is Owner Liable for</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moms or Mojave</td>
<td>Single Family Business Fort</td>
</tr>
<tr>
<td>None</td>
<td>Yes</td>
</tr>
<tr>
<td>Partnership</td>
<td>Yes</td>
</tr>
<tr>
<td>Limited Liability</td>
<td>Yes</td>
</tr>
<tr>
<td>Limited Liability Company</td>
<td>Yes</td>
</tr>
<tr>
<td>&quot;Limited&quot; or (silent) partner participation</td>
<td>Yes</td>
</tr>
</tbody>
</table>

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*Limited" or (silent) partners who participate in management may lose limited liability status.

**Lenders often require owners to pledge personal assets.
Partnerships

The general partnership is an organization of two or more persons who operate as co-owners. The partners contribute to, manage, and reap the profits from their business, and divide any profit.

Partnerships are usually created by written contract among the partners, but they can also be formed even without a written agreement.

Partners are separate legal entities in their own right. Each partner can have his or her own assets as a partner, use or be sued. A partnership must file an income tax return each year, but this return is for informational purposes only. The real income or loss from the partnership is taxed "through" to each individual partner's income tax return.

If a partnership, each partner may be liable for any and all debts of the partnership. This means that no owner partner can separate his or her own individual assets from those of the partnership. Liability is not limited to the business.

Another disadvantage of this form is that it's difficult to dissolve. If any partner dies, is incapacitated, or voluntarily leaves the partnership, the partnership entity cannot be dissolved. Any time a new partner joins, the old partnership is dissolved and a new partnership needs to be created. As with sole proprietorships, the ability and opportunities to raise capital rest solely on the financial resources of the partners.

The advantages of this form of organization are simplicity in formation and the democratic methods it offers in operation. It allows, for example, one partner to contribute cash, one to contribute technical know-how, yet another to contribute managerial know-how.

In farming, two somewhat distinct types of limited partnerships have arisen. Family, or closely-held, limited partnerships serve a number of objectives. Parent and/or child retirement may wish to maintain their investment in a farm business, but limit their liability and be free of management concerns. To accomplish this, the parents can be limited partners in a business where younger family members are the general partners.

Acquisition of debt capital for a family or closely-held business "through" to each individual partner's income tax return.

Large-scale limited partnerships in agriculture provide tax shelters for the limited partners and generate tax shelters for properties for the general partner, commonly a parent. The general partner normally provides only a small portion of the equity capital. In return for organizing and managing the partnership, the general partner normally gets an initial lump-sum management fee and a continuing management fee based upon the gross income of the business.

The joint venture is another variation of the partnership, usually more narrow in function and duration. A partnership is the law of partnership applies to joint ventures.

The primary purpose of this form of organization is to share the risks and profits of a specific business undertaking.

Corporations

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Corporations issue ownership shares in the form of common stock. The owners of this stock vote to elect a board of directors that manage the corporation for the shareholders. The corporation is not dissolved on the death of the owner.

A corporation is a separate legal entity that can own property, sue and be sued in its own right, contract to buy and sell, and be held in its own name. The owners usually cannot be made to pay any debts of the corporation. Their liability is limited to the amount of money they have paid or promised to pay into the corporation.

In farming, there are two different types of corporations - the regular (subchapter C) and the hybrid (subchapter S). The major difference between the two is that the subchapter C corporation pays no income taxes. Rather, income from the business is allocated to stockholders who then report this income on their personal income tax returns. In contrast, subchapter S corporations pay corporate income taxes, but dividend payments paid by the corporation must be reported by stockholders on their individual income tax returns.

Concern over this "double taxation" is a major reason some farmers and ranchers prefer limited liability corporations rather than subchapter C corporations.

To do so, the farm corporation must meet several requirements. (1) It must maintain no more than 35 shareholder stockholders, commonly known as "allotment". (2) It cannot have partnerships or other corporations as stockholders. (3) It cannot receive more than 20 percent of its gross receipts from interest, dividends, rents, royalties, annuities, and gains and profits from sales or exchanges of securities.

In agriculture, these restrictions usually mean that a closely-held farm businesses can achieve subchapter S status, and the advantages of corporate form are available to the owners of the farm business.

Meeting the requirements for subchapter S corporations are similar to regulations governing partnerships and sole proprietorships. However, corporations may provide certain employee benefits that are tax-deductible. Accident and health insurance, group life insurance, and certain expenses for recreation facilities qualify all. However, if these benefits may be taxable to the employees and subsequently to the corporation.

There is greater certainty for businesses organized under subchapter S than for sole proprietorships or partnerships. Upon death of a shareholder, their shares of the corporation are transferred to the heirs and the subchapter S election is preserved.

With this knowledge, the farmer can choose the form of organization best suited to his or her needs.

New Business Forms

Minnesota adopted a limited liability company (LLC) statute in 1992 to authorize another general partnership in organization option. The owners of a LLC are called "members," with (theoretically) no personal liability for the obligations of the LLC. However, as a partnership, a properly constituted LLC can be taxed like a "pass-through" entity for federal income tax purposes. No federal tax and, presumably, no state tax will be imposed on the LLC itself. The members include any income or loss on their own tax returns.

The affairs and conduct of the LLC business are governed by an operating agreement among its members.

Ownership is represented by membership interests. Management of an LLC may be elected by its members in proportion to their membership interests; however, the operating agreement may provide for the selection of managers by the members.

The managers do not have to be members, or like members, they have no personal liabilities to the obligations of the LLC.

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LLP status is available to newly-formed and previously-existing general partnerships. General partners may wish to consider registering as an LLP or to convert to an LLC. Because these forms are new, it is wise to proceed carefully in adopting either of them. Selection of a legal form of business by owners of farms or agribusinesses is important and involves consideration of possible legal liabilities, tax consequences, and operational management.

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Minnesota's number and size proportions are similar to the national averages, but non-family corporations and other legal forms are less important, perhaps due to the existence of the state's corporate farm law (which prohibits certain corporate, and limited liability entities from owning farm land or engaging in farm production). California tends to have partnerships that account for a disproportionate share of the state's farm land. Most Midwest states are similar to the U.S. Department of Agriculture.

In Minnesota, the proportions of farms identified as sole proprietorship and partnership have remained stable from 1982 to 1992 even though the absolute number of farms has decreased significantly year-to-year (see Table 2). Sole proprietorships have made up around 88 percent of the state's farms even though the actual number of farms declined by more than twenty percent in this ten-year period. A slight decline in the number of partnerships during the decade is offset by a relative increase in farm corporations. It should be stressed that only family

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Lenders often require owners to pledge personal assets. |
and closely-held (so-called "authorized") corporations are permitted to own land and engage in farming in this state. Average net cash returns are over two and one-half times larger for partnerships than for sole proprietorships (see Table 3). Farm family corporations in 1992 had nearly twice the net income of partnerships, but non-family corporations recorded almost ten times the average net return of proprietorships. Off-farm income has become much more important. As a result fewer sole proprietors identify farming as their principal occupation. Farms with other types of business organization tend to specialize in farming.

From other census data (not shown here), we find that sole proprietorships are the most predominant type of business organization for farms with livestock as their primary product. Partnerships are more common for dairy farms, and family corporations are of relatively greater importance for field crop farms.

Summary

Several alternatives are available for newly-formed or changed farm businesses. In addition to the popular sole proprietorship form, there are three types of partnerships, two types of corporations, and a new limited liability company. The specific form an individual chooses depends mainly on convenience. Although there is some measure of protection for farmers, the number and importance of partnerships and corporations have grown in the past three decades. The quest for new capital, ease of operation, and limited liability has fueled the development of new forms of doing business. Whether or not an existing farm business should change its organizational structure depends on the objectives of its owners and on the tax implications of adjustment.

Additional Suggested Reading


Yields

Crop productivity patterns are shown in Figures 3, 4 and 5 for corn, soybeans and wheat. In the maps, the four clusters are shaded according to the range of yields, with the darkest shading for the highest yield group and white for the lowest.

Clusters for corn and soybeans show similar patterns, with highest yields in the south central and south-eastern parts of the state, fading somewhat into the south and central areas. The notable difference is the way the soybean yield clusters tend to a more northern counties, particularly in the west central and northwest.

Yield patterns in wheat productivity are perhaps more difficult to interpret. The highest yield cluster is in the heart of the wheat-producing part of the state. Patterns in the other three clusters are less distinct, with southern counties appearing in all four groups. This result has less to do with relative productivity than with the marginal role of wheat in the south. Production likely occurs here on marginal land with less efficient management practices.

County Patterns

To portray regional patterns in crop production and productivity in Minnesota, we used a statistical technique called cluster analysis. This procedure first measures differences between counties and then assigns counties to categories that minimize variation within categories.

For each crop, two variables were computed at the county level — (1) harvested area for that crop as a percent of total harvested crop area and (2) five year average yield for that crop.

The former is an indicator of intensity of production of a particular crop. It allows counties of different sizes with different areas of tillable land to be compared. Crop yield is an indicator of relative productivity. A five-year average yield eliminates vagaries in the data that may be attributed to weather patterns in particular years.

Cluster analysis combines counties into a designated number of groups (clusters) so that group members are similar with respect to one or more attributes. In our analysis, we used four clusters, but analysts could select any number for their work.
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**Summary**

Several alternatives are available for newly-formed or changed farm businesses. In addition to the popular sole proprietorship form, there are three types of partnerships, two types of corporations, and a new limited liability company. The single sole proprietorship continues to be Minnesota farmers' organizational favorite, but the number and importance of partnerships and corporations have grown in the past three decades.

The quest for new capital, ease of operation, and limited liability has fueled the development of new forms of doing business. Whether or not an existing farm business should change its organizational structure depends upon the objectives of its owners and on the tax implications of adjustment.

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Coverage

Figures 6, 7 and 8 show the clusters of counties grouped by "coverage" — the relative size of corn, soybeans and wheat plantings, compared to total crop area. Data for 1991 were used.

The most intensive corn production follows the pattern of highest yields quite closely. The highest cluster includes counties with 36% to 50% of cropland in corn. All southern Minnesota counties are in this group, which spreads north into the central part of the state as well.

Five southern counties form the top group in soybean production with 36% to 60% of cropland. Again, the intensity of production follows the pattern seen in yields, with a notable exception. Despite their appearance in the highest yielding clusters, southeastern counties bordering the river are grouped with mostly northern counties having the least acreage of soybeans. In the southeast, crop mixes tend to be corn and hay, rather than corn and soybeans. Following the yield patterns, however, relatively high levels of soybean production continue northward along the western side of the state.

As Figure 8 shows, wheat production in 1991 was highly concentrated in the northwest — all counties in the top two clusters are in that area. Wheat coverage fades as we move south.

Changes in Coverage

Changes in patterns of production are shown in Figures 9, 10 and 11. The clusters in these maps show the change from 1976 to 1991 in crop area as a percent of total cropland. So, for example, if a county's wheat coverage went from 37% in 1976 to 30% in 1991, we show it as a decrease of 7 percentage points and color it white in Figure 11.

The largest percentage increases in corn acreage are seen primarily in central and southwestern counties. Figure 10 shows relatively large increases in soybean acreage in the west central and southwestern production areas. Some of the expansion of soybeans in the west central and northwest appears to have occurred at the expense of wheat. Figure 11 shows declining areas of wheat land concentrated along the western border of the state.
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Does the corn crop tell us anything about farm profitability?

We often see crop yields used to suggest farm financial health. The implication is that high yields result in strong sector performance. Data from actual farm records compiled by the Southwestern Minnesota Farm Business Management Association suggest a different conclusion. Note especially the evidence from 1983 and 1994. A 150% increase in average corn yields resulted in exactly the same net average income for member farmers.
Women Who Farm: Wider Attention to a Growing Subgroup

Kimberly A. Zeuli and Richard A. Levins

From 1978 to 1992, the proportion of women farmers in the United States grew from 3.2 percent to 7.5 percent of the total farm population (Figure 1). These small numbers hide a much larger economic fact: almost half of all farmland in Minnesota is leased (see box on page 4), and 40 percent of that leased land is owned by women. Obviously, most women in farming are not doing the farming themselves. These figures reveal a new trend in American agriculture: an increasing role for women in both the production of our food and the ownership of our farmland.

For the most part, this trend has gone unnoticed. One commentator noted: "There are women connected in some way with most U.S. farms, but the work of these women is even less noticed [than the work of other women], since farming is thought to be done by men." Last year, we conducted a series of interviews to learn more about women who farm in Minnesota. Both the results of that study and the public reaction to it are worth looking at.

Women Farmers in Minnesota

Although 2,931 women farmers were reported in the 1992 Minnesota Census, they are not easy to find. We worked with several groups to identify 20 women who met the Census definition of an independent farm (See Women page 2).

Figure 1. The Proportion of Farmers Who Are Women is Steadily Rising.

New Walleye Size Rules: How Will Minnesota Anglers Respond?

Jane Rullifson and Frances Homans

Introduction

Minnesota highways are jammed on the day before the walleye opener, and boat launches fill early the next morning with anglers eager to catch the first walleye of the season. The rest of the summer may not be quite as intense as those first few days, but walleye fever continues to infect Minnesotans throughout the summer and into the ice-fishing season.

But even as anglers try more often and use more sophisticated equipment, they are bringing home smaller and smaller fish. The increasing harvest means that it is harder for a walleye to