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**Review of
North Dakota Corporate
Farming Statute
in Anticipation of
the 1985 Legislative Session**

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FOREWORD

This report is the second of two discussing North Dakota's corporate farming statute. The research was conducted as part of ND 3353--Analysis of Laws Affecting Agriculture with the results initially presented in an unpublished Masters paper prepared by the author. Drs. Donald F. Scott, William C. Nelson, David W. Cobia, and F. Larry Leistritz and Mr. Richard B. Crockett served as committee members, reviewers, and helpful sources of information. To them and Ms. Cindy Danielson who typed the manuscripts, the author extends his grateful thanks.

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HIGHLIGHTS

North Dakota's corporate farming statute, after nearly 50 years without changes, was amended by both the 1981 and 1983 sessions of the state legislature. The statute continues to prohibit corporations from owning or operating farmland within the state but includes six exceptions. The industrial and business purpose exception and part of the tax-exempt nonprofit exception will expire on June 30, 1985, thereby forcing the 1985 legislature to again consider the corporate farming statute. This may also be an opportunity for the lawmakers to review other sections of the law.

More specifically the review could consider some of the requirements imposed on family farm corporations, their shareholders, officers and directors. The legislature may also want to review the exception for surface coal mining operations in addition to those for tax-exempt organizations, and industrial and business purposes.

REVIEW OF
NORTH DAKOTA CORPORATE
FARMING STATUTE
IN ANTICIPATION OF THE
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by

David M. Saxowsky

Since 1932, North Dakota has prohibited corporations from owning land within the state. Not until the 47th session of the North Dakota legislature (1981) was this general prohibition amended to allow family farms to incorporate and own farmland. This exception, however, is available only if the organization meets all the requirements set forth by statute. The 48th session of the legislature (1983) again amended the statute to resolve ambiguities of the 1981 law and allow additional types of corporations to own farmland in North Dakota but under more restrictive circumstances than is required of family farm corporations. Two of these additional exceptions will expire on June 30, 1985 unless the 1985 legislature acts to continue them. In addition, the 1983 legislature requested an interim study of farmland ownership by nonprofit corporations in anticipation of the 1985 session.

This report presents a brief history of North Dakota's corporate farming statute, explains the law as it exists after the 1981 and 1983 amendments and suggests changes the 1985 legislature may consider. This report is not a discussion of corporate tax law nor of general principles for using the corporate business structure. Ideas for managing a corporation owning farmland in North Dakota to reduce the possibility of violating the statute are discussed in an earlier report.¹

There are seven sections in this report. The first section presents background information about the corporate farming statute. This information is categorized as pre-July 1, 1981; after June 30, 1981; and current statute. The second section is an explanation of the general prohibition against corporations owning farmland or engaging in farming in North Dakota. The next four sections address selected provisions of four of the exceptions to the general prohibition--particularly those provisions that are open to more than one interpretation. The last section is a discussion of implications of unanswered questions as well as an approach to clarify the law's objective.

I. Background

A. Pre-July 1, 1981

North Dakota has had a corporate farming law since 1932. That year, during the depth of the great depression, an initiated measure was passed by the voters of the state prohibiting domestic and foreign corporations from "engaging in the business of farming or agriculture."²

The measure, which resulted in part from a concern over ownership by corporations of farms and farmland acquired primarily through foreclosure,³ also prohibited all corporations "from acquiring and holding real estate" regardless of its use.

Corporations owning real estate on the day the initiated measure was approved were required to dispose of the property within 10 years but were allowed to farm the land until disposition. If the real estate had not been disposed of within the established period, the state's attorney was empowered to institute an action for the title to escheat to the county in which the real estate was situated. The county had one year to sell the real estate at public auction to the highest bidder and return the proceeds, minus expenses, to the corporation.

Three exceptions were included in the law. The first exception allowed cooperative corporations to own real estate or conduct farming or agricultural business if 75 percent of the members or shareholders were actual farmers, residing on farms or depending principally on farming for their livelihood. The meaning of these requirements has never been expanded.

Second, corporations could own real estate but not "in excess of that necessary for the conduct of their business." This exception, however, did not explicitly allow the landowning corporation to farm the land. The general prohibition against corporations engaging in farming or agriculture prevented any argument that the land was necessary to conduct a farm business. It was implicit that corporate ownership of necessary real estate was permitted only for businesses in which corporations could lawfully engage.⁴

The third exception allowed corporations to acquire real estate as long as the acquisition occurred in the course of corporation business and by judicial process or operation of law such as foreclosure. Without this exception, corporations such as insurance companies and banks would have discontinued lending capital to landowning farmers on the basis that mortgages were not security. Real estate acquired under this provision and not necessary to conduct the business of the corporation must have been disposed of within 10 years after acquisition or be subject to escheatage. Corporations could farm and use the real estate for agricultural purposes during the period of ownership.

The 1933 legislature amended the law by deleting the prohibition against acquiring and holding real estate but required all corporations holding rural real estate, used or usable for farming or agriculture, to dispose of it within 10 years.⁵ This allowed corporations to retain nonrural real estate as well as rural real estate not usable for farming or agriculture. The legislature also provided that the 10-year limitation was a covenant running with the land against successor corporations which prevented the law from being evaded by simply transferring real estate to another corporation just before the 10-year period had passed.

In 1935, the legislature again amended the statute by expanding the section of the statute which declared title to real estate owned by corporations to be valid and legal regardless how ownership was acquired.⁶

After the 1935 amendments, the corporate farming statute prevented farm operators from incorporating their businesses but allowed nonfarm corporations to own and farm land for 10 years after acquiring the real estate. Similarly, it did not prohibit corporations from re-acquiring their land sold at the county public auction nor effectively penalize the corporation for engaging in farming.

Some farmers avoided the statute by organizing their businesses as joint stock companies. These companies had many of the same features as a corporation but did not violate the letter of the law which only addressed corporations. The 1978 Census of Agriculture indicated 131 corporations operating farms within the state,⁷ further evidence that the law did not prevent corporate farming.

Attempts to amend the statute were made both in the legislature and by use of the initiative.⁸ Some of the attempts were to prohibit or more severely penalize corporations that engaged in farming. Other attempts to amend the statute would have eased the statute by allowing certain corporations to farm.

Recent legislative sessions during which amendments to the corporate farming statute were introduced include 1959, 1961, 1963, 1967, 1969, 1971, 1979, and 1981. In 1967, the legislature passed a bill allowing certain closely held corporations to farm.⁹ The bill was vetoed by the governor but the veto was overridden by the legislature. Sufficient referral petitions were filed to place the question on the 1968 general election ballot and the measure was defeated at that time.¹⁰ In addition, the voters, in 1974, defeated an initiated measure to amend the statute.¹¹ The statute remained unchanged until 1981 despite the numerous attempts to amend it.

B. After June 30, 1981

The 1981 legislature continued the general prohibition against corporations owning land within the state.¹² Likewise, it continued the exception for cooperative corporations¹³ and included, for the first time, an exception allowing family farms to incorporate and own land.¹⁴ The legislature discontinued the "reasonably necessary" exception for businesses and modified the exception for corporations that acquire land through process of law in the collection or enforcement of debts and mortgages.¹⁵ Land acquired under this last exception must be divested within three years of acquisition rather than 10 years as allowed by pre-1981 law.

The 1983 legislature addressed at least six bills that would have amended the corporate farming statute but only three passed both houses. The first to pass both houses (House Bill 1563) established a fourth exception by allowing corporations engaged in surface coal mining to own or lease farmland that is reasonably necessary in the conduct of its business.¹⁶ The exception ceases when the land is no longer necessary to the operation. The statute is not clear but it appears the cessation will be on a tract-by-tract basis.

The second bill to pass both houses (House Bill 1478) provided an exception for tax-exempt nonprofit corporations and certain trusts.¹⁷ This encompasses churches, schools, and other organizations operated exclusively for religious, charitable, scientific, literary, and educational purposes as long as no substantial part of the organization's activities involves attempting to influence legislation [Internal Revenue Code, Section 501 (C)(3)]. This bill was vetoed by the governor and not overridden by the legislature.¹⁸

The third bill (Senate Bill 2244) passed late in the session and clarified ambiguities of the 1981 law. Due to its late consideration, the bill was amended to include the tax-exempt nonprofit exception that had already been vetoed. Further restrictions were imposed on these organizations, however, in order to receive the support needed to include the vetoed material in the third bill.

Senate Bill 2244 also included an exception for corporations involved in 1) development of land for residential and commercial purposes or 2) siting buildings, plants, facilities, and industrial parks.¹⁹ This exception as well as some of the restrictions imposed on tax-exempt nonprofit corporations will expire on June 30, 1985. The expiration was included as a compromise with the expectation that the 1985 legislature will review the statute. The 1983 legislature, in anticipation of the review and in response to the governor's veto message, requested an interim study to "determine types of nonprofit corporations or trusts which should be allowed to own or lease farm or ranch land and the conditions of such ownership or lease."²⁰

C. Current Statute

The current statute continues the general prohibition that no corporation may own or lease land used for farming or ranching nor may any corporation engage in the business of farming or ranching. The statute, however, provides six exceptions to this general rule:

- 1) Domestic family farm corporations may own real estate and engage in the business of farming or ranching
- 2) Cooperative corporations 75 percent of whose members are farmers are allowed to acquire real estate and engage in farming or ranching

- 3) Any corporation may acquire farm or ranch land by process of law in the collection of debts or enforcement of a lien or claim whether created by a mortgage or otherwise
- 4) Corporations conducting surface coal mining operations or related energy conversion may own or lease land used for farming
- 5) Tax-exempt nonprofit corporations and certain trusts may own or lease farm or ranch land; and may continue active engagement in farming or ranching if the tax-exempt nonprofit corporation was doing so on January 1, 1983
- 6) A corporation may own or lease land used for farming or ranching if the land is necessary for residential or commercial development, or the siting of buildings, plants, facilities, or industrial parks.

II. General Prohibition

The range of activities prohibited by the current law is more encompassing than the 1932 initiated measure as originally passed or amended. Corporations are now prohibited from 1) owning land used for farming (read farming to mean "farming or ranching" and farm as "farms or ranches"), 2) leasing land used for farming, and 3) engaging in the business of farming. Farming is defined by the statute to mean:

Cultivating land for production of agricultural crops or livestock, or the raising or producing of livestock or livestock products, poultry or poultry products, milk or dairy products, or fruit or horticultural products. It does not include production of timber or forest products, nor does it include a contract whereby the processor or distributor of farm products or supplies provides grain, harvesting, or other farm services (NDCC 10-06-01.1).

The objective of the statute is to prohibit corporations from owning or leasing land used for farming or engaging in the business of farming yet allow North Dakota farm families to incorporate and benefit from the corporate business organization without being in violation of state law.

The phrase defining which land a corporation may not own is "land used for farming."²¹ In comparison, the 1932 law applied to land "used or usable for farming."²² Although it could be argued that the term "used" applies to all land used or usable for farming, there is case law in North Dakota which says the statute must be read more narrowly. The North Dakota Supreme Court,²³ interpreting the repealed prohibition against corporations acquiring title to land, stated:

It will be noted that the act does not expressly prohibit corporations from acquiring title to farm lands, although it is possible to argue that the act does so by implication. On the other hand, there are persuasive reasons why that implication should not be read into the law. The first reason is that the original act contained a specific prohibition against the acquisition of real estate by a corporation which was deleted by the amendment.

By analogy, the original act contained a specific prohibition against corporations acquiring land usable for farming which was deleted by an act of the legislature; accordingly, the current statute must be interpreted to allow any corporation to own land usable for farming as long as it is not used for farming. Agruably the state has no protection against corporations desiring to speculate in land because they (corporations) can acquire any farmland within the state as long as they cease using it for farming.

Some may argue that a corporation will never buy land in North Dakota unless it can farm the land or at least rent it to a farmer. However, land, due to appreciation of its value, can be and often is an attractive investment even though it is not producing a cash inflow. The land, in that case, is held for speculation with the owner most likely intending to sell it several years later. If a corporate owner cannot use the land for farming during this time, perhaps it would be planted to grass and allowed to remain idle; even the hay would not be harvested.

Such a strategy could produce an additional benefit. If two similar tracts of land were available for purchase, would not a farmer choose to purchase and be willing to pay a higher price for land that has not been used for several years? Though the objective of the statute is to prohibit corporations from owning farmland, by simply omitting a single phrase, the law may encourage corporations to act in a manner contrary to the presumed objective of the statute. On the other hand, a simple amendment to the corporate farming statute by replacing each "land used for farming" with the phrase "land used or usable for farming" will eliminate this interpretation and more closely align the law with its objective.

III. Domestic Family Farm Corporation Exception

One group of corporations exempt from the general prohibition is domestic (incorporated in North Dakota) family farm corporations; that is, all shareholders must be related. A foreign corporation (incorporated somewhere other than North Dakota) will need to establish a corporation within the state with all its stock held by family members if they desire to also operate within North Dakota. Similarly, state law does not prevent a family living outside North Dakota from incorporating in the state as long as the other requirements of the statute are met.

Domestic family farm corporations must meet seven requirements²⁴ and file requisite reports in order to be exempt from the general prohibition. The following discussion focuses on requirements with unclear language and unanswered questions.

A. Number of Shareholders

The corporation must not have more than 15 shareholders [NDCC 10-06-07 (1)].

This is not as simple as counting how many persons own stock. If any shares are held by trusts or estates, the number of beneficiaries plus the number of shareholders can not exceed 15. A husband and wife each owning stock most likely will be counted as two shareholders, though the statute does not explicitly address the issue. It also appears that each person having an ownership interest in jointly-held stock will be counted as a shareholder.

B. Shareholders Related Only by Marriage

Several questions arise in interpreting the meaning of the statutory language "or the spouse of a person so related."²⁵ First, is the statute violated if the spouse of the nonrelated shareholder (that is, the shareholder who is not related by blood but is related only by marriage) is not a shareholder. The language of the statute only requires the spouse upon whom relationship is based to be a "person." The statute does not require the spouse to be a shareholder. Therefore, the statute should be interpreted to mean there is no violation if the spouse of the nonrelated shareholder is not also a shareholder.

A related question is whether two persons, who are each married to a sibling, can form a domestic farm corporation and meet the requirements of the statute even though their spouses (the siblings) are not shareholders? Again the answer appears to be yes because the statute only requires nonrelated shareholders to be married to a person who is related to all other shareholders within the listed degrees of kinship. Each one of the siblings will be the spouse of one shareholder and the sibling of the spouse of the other shareholder and would not violate the words of the statute.

It appears the statute will not allow a nonrelated shareholder to continue as a shareholder after termination of the marriage by either divorce or annulment. At that point, the two persons are no longer spouses and will not be able to rely on their former marriage. A nonrelated shareholder, on the other hand, should be permitted to rely on the marriage even though the couple is separated. In such a circumstance, however, it is probably the related shareholders who are more concerned about violating the statute than the person who will likely no longer be a member of the family.

The next question is whether the nonrelated shareholder can continue to be a shareholder after the death of the spouse. The statute does not explicitly require the person upon whom the relationship is based to be alive. It merely requires the shareholder to be the "spouse of a person so related." The surviving nonrelated shareholder should be able to continue as a shareholder even after the death of the spouse. Any other interpretation would result in undesirable situations.

One such situation would be a farm corporation with four shareholders; a married couple, their son, and a brother of the husband. The wife (nonrelated spouse) and the brother-in-law are related only through the husband; consequently, that is the only basis for allowing both of them to be shareholders. This middle person is removed with the death of the husband. It would seem unfair to force out either the surviving spouse (mother) or brother (uncle) simply because the husband died. Both the wife and the brother may have spent most of their lives working for the business with the hope that someday the son (nephew) will own it. Any other interpretation would force a family to reorganize their farm corporation simply because a married shareholder passes away.

Finally, can the nonrelated surviving spouse continue to be a shareholder after remarriage to a nonfamily member? At this point, the remarried shareholder is no longer the spouse of the relative but is instead the spouse of someone else. The remarried person will most likely be required to relinquish his or her shares of stock. This would be analogous to the estate planning strategy of terminating, upon remarriage, the right of the surviving spouse to property left by the first spouse. In addition, the remarried shareholder would be permitted to sell or give the stock to a related person of his/her choice.

C. Protection of Minority Shareholders

The 1981 Legislature included unique provision to protect minority shareholders from not being able to sell their stock in the family corporation.²⁶ The language of the statute would seem to indicate that this provision applies only to shareholders who are attempting to dispose of all their ownership in the corporation; that is, the language of the statute addresses the "withdrawing" shareholder. It would be inconsistent with the purpose of this provision, however, to narrow its application. Shareholders selling less than all their shares in a family farm corporation may encounter the same difficulty in consummating a sale as shareholders who are attempting to dispose of all their interest. Therefore, it would seem appropriate to apply this statutory scheme to all sales of stock by minority shareholders.

D. Individuals and Certain Trusts and Estates

Each shareholder is an individual, except that any of the following may also be shareholders:

- A. A trust for the benefit of an individual or a class of individuals who are related to a shareholder of the corporation within the degrees of kinship specified in this section.
- B. An estate of a decedent who was related to a shareholder of the corporation within the degrees of kinship specified in this section.

Neither a trust nor an estate may be a shareholder if the beneficiaries of the trust or the estate together with the other shareholders are more than 15 in number [NDCC 10-06-07 (3)].

Both the number and relationship requirement must be met when a trust or estate owns stock. The number of shareholders is the number of beneficiaries plus all other shareholders, but a person who is both a beneficiary and directly owns stock should be counted as one.

The statute requires beneficiaries of a trust which owns stock to be related to "a shareholder." This implies that the beneficiaries do not need to be related to all shareholders. If that is the case, establishment of a trust is a way to circumvent the relationship requirement. Such a narrow reading, however, is not the spirit of the statute nor the purported intent of the legislature. Most likely the language will be amended or interpreted to require beneficiaries to be related to "all shareholders."

The statute does not specify if the trustee must be a related individual or whether a corporate trustee would be acceptable. Arguably, any type of trustee is permissible as long as the requirements are met by the beneficiaries of the trust. A different interpretation could complicate estate planning for families that have incorporated their farm business.

The definition of a qualifying estate is also ambiguous. The determining factor for the relationship requirement for estates is the decedent and not the beneficiaries as is the case for trusts. The statute requires that the decedent had been related to "a shareholder;" not all shareholders. If the statute is strictly read, more estates would qualify to be shareholders than would living persons; that is, a living person needs to be related to all shareholders but an estate qualifies if the decedent was related to only one shareholder. This, again, does not align with the apparent spirit of the statute.

In amending the statute, it may be appropriate to allow the estate of a deceased shareholder to own stock as long as the number of beneficiaries does not cause the total number of shareholders to exceed 15. This change would not cause any hardship because the decedent, in order to have been a shareholder before death, would have been related to all other shareholders--not just one other shareholder. In addition, few estates will own stock unless the decedent had been a shareholder. This is somewhat stricter than the present statute but does not alter the rule

that the beneficiaries do not have to meet the relationship requirement while the stock is owned by the estate. Likewise, it continues to limit the corporation to 15 shareholders and beneficiaries.

E. Citizens or Permanent Resident Aliens

Each individual who is a shareholder is a citizen of the United States or a permanent resident alien of the United State [NDCC 10-06-07 (4)].

The statute is not clear whether indirect shareholders, especially beneficiaries of a trust, must be citizens. A trust could be established to involve noncitizen relatives in the North Dakota farm corporation if the statute is interpreted to require only direct shareholders to be citizens.

F. Officers and Directors

The officers and directors of the corporation must be shareholders who are actively engaged in operating the farm or ranch and at least one of its shareholders shall be an individual residing on or operating the farm or ranch [NDCC 10-06-07 (5)].

There are three requirements in this statement. First, officers must be shareholders who are actively engaged in operating the farm. Second, directors must be shareholders who are actively engaged in operating the farm. Third, one shareholder must be an individual residing on or operating the farm.

This requirement initially posed a problem for persons wishing to incorporate with less than three shareholders. The business corporation statute requires that North Dakota corporations have at least two officers²⁷ and three directors.²⁸ The 1981 legislation was not clear whether the business corporation act applied to farm corporations, but if it did (and it certainly would), farm corporations would have to have at least three shareholders who would function as directors and fill the two offices.

The Attorney General issued an opinion stating that corporations with less than three shareholders could have less than three directors;²⁹ this, however, did not resolve the implicit requirement of needing two shareholders to fill the two offices.

The 1983 legislature resolved these questions. First, it clarified that the business corporation act applies to farm corporations, but in case of conflict, the farm corporation act prevails.³⁰ An additional amendment now permits a farm corporation with one shareholder to have only one director with the shareholder serving as the director, president, and treasurer. Other offices can be filled by persons who are

not shareholders. In the case of a corporation with two shareholders, only two directors are required but both directorships and all general corporate offices must be filled by the two shareholders.³¹

Directors and officers are required to be actively engaged in operating the farm. Unfortunately, neither the 1981 nor the 1983 legislatures defined "actively engaged in operating the farm." The only indication of the meaning of this phrase is found in legislative history from the 1981 session. The sponsors of the law did not intend "actively engaged in operating the farm" to mean material participation as defined by federal tax law.³²

This lack of definition raises three problems. First, officers and directors of farm corporations have no indication what level of activity is required. Will they be considered actively engaged if other shareholders or employees perform the actual farming operations, or must the directors and officers feed the livestock and drive the machinery? Second, enforcement will be difficult, if not impossible, without a definition. The intent of the legislature may have been to require directors and officers to be more involved in the farming operation than an absentee landlord; but without a definition, the agencies responsible for enforcing the corporation farming law have no guidance. Finally, the vagueness of the statute leaves it open to constitutional challenge.³³

The third part requires the corporation to have at least one shareholder who is an individual residing on or operating the farm. Several statements can be made about the definitions of various terms assuming the third part of this requirement is more stringent than the first two parts. (The third part of this requirement has no purpose if this assumption is not accepted.)

First, directors and officers do not have to be individuals, and trusts and estates are the only artificial entities permitted to be shareholders; therefore, trusts and estates must be capable of being directors and officers. Consequently, active engagement in operating the farm is possible through agents since estates and trusts only function through their agents.

Second, operating the farm, by the inevitable assumption, is a higher level of activity than actively engaged in operating the farm. As a consequence, directors and officers are not required to operate the farm; these operations, if not performed by the directors and officers, most likely would be performed by other shareholders or employees of the corporation. Neither the level nor type of activity that constitutes operating the farm, however, have been delineated in the law.

A related question is whether directors and officers can be actively engaged in operating the farm if the operation is performed by a tenant. A cash or nonparticipating share crop lease will not meet the statutory requirement because neither the landlord corporation nor its agents are involved in operating the farm business. Furthermore, income received by the corporation from the operation would be considered rent

which is restricted by the statute to be less than 20 percent of the corporation's gross receipts. The limitation on the amount of passive income a farm corporation can receive is addressed again on page 25.

The statute gives no indication whether a participating crop-share lease sufficiently involves directors and officers to regard them as actively engaged in operating the farm. There are actually two concerns in this statement. First, is the corporation "engaging in the business of farming,"³⁴ or is it simply leasing farmland? The most generally accepted legal test is whether the land owning entity is materially participating in the operation of the business. This test is applied in several different settings throughout federal tax law for resolving whether the arrangement is a lease or a business; e.g. Sections 2032A, 1402, 543, 6166, I.R.C. State courts, however, may decide to apply a different test.

The second concern is, if a corporation is engaging in farming, are the officers and directors sufficiently involved to be considered actively engaged in operating the farm? Again, the answer depends on the definition of this key phrase--actively engaged in operating the farm.

Even if the corporation cannot lease its land, there are alternative arrangements which facilitate the corporation taking a less active role in the farm operation. These arrangements include: 1) the corporation being in partnership with an actual operator (who would not have to be a family member) or 2) paying employees of the corporation a portion of production or basing wages on the level of production.

Third, the more stringent requirement includes the alternative that an individual shareholder reside on the farm. Directors and officers, by implication, are not required to reside on the farm because this part would not be requiring anything additional if the directors and officers are expected to reside on the farm.

Fourth, the shareholder who resides on or operates the farm can be a token shareholder, that is, owns as little as one share of stock.

Fifth, a trust or an estate cannot be the sole shareholder of a family farm corporation. There must be at least one shareholder who is a natural person (i.e., an individual), even if the interest is only token. This statement is made assuming that having an indirect interest in the corporation (i.e., being a beneficiary of a shareholding trust or estate) is not sufficient to meet this requirement. If this assumption is not made, a farm corporation does not need an individual direct shareholder as long as one beneficiary resides on or operates the farm.

Sixth, a token individual shareholder who resides on the farm does not need to operate it since the requirement is in the alternative.

Seventh, the definition of residing on the farm is not clear. Does a shareholder have to live on the farm or will a person be considered residing on the farm by living in a nearby town? Shareholder/employees who commute to the farm will most likely be considered operating the farm and thus meet this requirement because of their involvement in the operation rather than due to their residence. Therefore, the primary question is whether the requirement can be met by an individual shareholder who lives nearby but does not work on the farm? If the answer is no, then, paradoxically, the individual shareholder who works on the farm can live off the farm, whereas a farm corporation which relies on one of its individual shareholders to reside on the farm even though not working on it, must have the shareholder living on the farm. The geographic limitation is not clear and interpretations will vary depending on the perceived purpose of this alternative.

There is some concern that the death of the individual shareholder who is either residing on or operating the farm will leave the corporation in violation of the statute and subject to potential dissolution.³⁵ This concern can probably be overcome by ensuring that a surviving family member who resides on the farm owns some stock and thus meets the requirement even though this individual is not operating the farm.

A synthesis of these statements demonstrates that this requirement does not prevent farm corporations from functioning as absentee landlords. All requirements are met if the corporation has 1) an individual shareholder residing on the farm even if he or she is not involved in its operation; and 2) directors and officers actively engaged in operating the farm even though they do not operate or reside on the farm. The corporation could be in a partnership with the actual farm operator, or the corporate employees' pay could be based on production. The corporation, in such arrangements, could have a minor role in the actual farm operation as long as the directors and officers are considered actively engaged in operating the farm.

The 1985 legislature should define "actively engaged in operating the farm" and "operating the farm" in an effort to resolve some of these problems. Operating the farm could mean performing day-to-day activities of farming including both physical efforts and daily management decisions. The legislature should also eliminate residency by an individual shareholder as a means of complying with the statute. These changes would assure that each corporation has at least one shareholder who is a natural person actually operating the farm.

An alternative proposal is to replace the requirement that one individual shareholder operate or reside on the farm with a requirement that a specified percentage of stock is held by individuals operating the farm. This alternative is proposed assuming the purpose of the corporate farming statute is to allow family farms to use the corporate business organization but prevent persons not operating farms from incorporating farmland or farm operations.

This proposal, however, raises several concerns. First, what percentage of stock should be required to be held by individual shareholders operating the farm? Second, stock held by trusts and estates would have to be either 1) not included as stock owned by individuals operating the farm or 2) attributed to the beneficiaries in equal percentage or according to their interests, if they are specified. The latter approach would ease meeting this requirement as stock attributed to individuals operating the farm would be included as stock held by individuals operating the farm. Third, some natural events could result in a violation of this requirement. One such event is retirement of a major shareholder; that is, father and mother retire still owning the major interest in the family farm business. To reduce this problem, operating could be defined to include retired shareholders who operated the farm until their retirement. Furthermore, the statute could specify a time period after retirement when the stock owned by or for the benefit of a recently retired but formerly operating shareholder would be included as held by persons operating the farm. This time period could be several years in duration and would provide an opportunity for retirees to sell or gift their stock to individuals currently operating the family farm business. A similar exception may be necessary for estates of operating shareholders.

A fourth problem is when the stock is held by or for the benefit of individuals too young to operate the farm. This could result if a major shareholder dies leaving stock to young children. One suggestion would be to ignore stock held by individuals too young to participate in operating the farm. Consequently, this stock would not be included as part of the corporation's total stock for purposes of this requirement.

The definition of actively engaged in operating the farm should emphasize management, since that is the responsibility of directors and officers, but their involvement in management should be more than establishing general corporate policy. Perhaps directors and officers should be required to be involved on a regular basis (weekly or biweekly) to review current corporate activities and make management decisions about important farm activities such as planting, harvesting, and marketing.

These definitions will not adversely affect farm families because the shareholders/directors will often be the persons actually operating the farm. Problems will arise primarily when the owners and managers are not the persons actually performing the farming activities; that is, those situations in which the individuals were never intended to be allowed to incorporate.

G. Income Derived from Farming Operations

An annual average of at least 65 percent of the corporation's gross income over the previous five years, or for each year of its existence, if less than five years, shall have been derived from farming or ranching operations
[NDCC 10-06-07 (6)].

The purpose of this requirement is to assure that the major activity of the corporation is its farming operation yet allow some minor nonfarm activities.

The legislature included a five-year time period for computing whether 65 percent of the corporation's gross income is from farming operations. Unfortunately, the statute is not that clear. The legislature most likely meant to require that

at least 65 percent of the corporation's gross income over the previous five years (or for its existence, if less than five years) shall have been derived from farming or ranching operations.

Legislative history suggests that this interpretation was intended to reduce the possibility of a statutory violation in years of poor production, low prices, high rate of storage, or low farm income.³⁶

Gross income is not defined by the statute and one possible meaning is total cash received by the corporation. A second meaning would be to include changes in inventory and accounts receivable as well as cash.

The statute does not specify how to compute the percentage. One method (call it Method A) is to total both the corporation's gross income and gross income derived from farming activities for the past five years. The percentage would be computed from these two totals. A second method (Method B) is to compute a percentage for each year and average the five percentages. These two methods produce different numeric results and, in some cases, different legal results (Table 1). The difference is due to the weights the methods placed on the data. The first method appears more logical because dollar amounts rather than percentages are emphasized.

The 1985 legislature should amend this requirement to clarify its meaning, define gross income, and designate a method of computing the percent of gross income derived from farming. These changes should be made knowing the statute also limits income derived by farm corporations from passive sources to 20 percent of gross receipts and that this term, likewise, is not defined. Whether gross receipts has the same meaning as gross income is not clear from the statute, but the use of different terms suggests a difference in meanings. Gross receipts, however, should mean cash received by the corporation regardless of the meaning of gross income.

H. Reports

H.1. Initial Reports

North Dakota farm corporations must file an initial report before they may commence farming or ranching³⁷ and annual reports each year

TABLE 1. METHODS OF COMPUTING THE PERCENT OF THE CORPORATION'S GROSS INCOME DERIVED FROM FARMING

Year	Example 1			Example 2		
	Total Gross Income	Farm Gross Income	Annual %	Total Gross Income	Farm Gross Income	Annual %
1	\$ 34,000	\$ -0-	-0-	\$ 60,000	\$ 60,000	100
2	160,000	126,000	78.75	90,000	60,000	66.7
3	102,000	68,000	66.7	90,000	60,000	66.7
4	102,000	68,000	66.7	130,000	60,000	46.1
5	102,000	68,000	66.7	130,000	60,000	46.1
Total	\$500,000	\$330,000		\$500,000	\$300,000	
Average*						
Method A	66%			60%		
Method B			55.75%			65.1%

*Method A: Farm gross income/total gross income.

Method B: Simple average of the annual percentages.

after incorporating.³⁸ The initial report, to accompany filing the articles of incorporation, was included in the 1983 amendments to clarify that existing corporations and joint stock companies cannot begin to treat themselves as farm corporations without creating a new entity.

The number of counties in which the notice must be published is broader than the prescribed statement. The notice must be published in all counties in which the corporation owns or leases any land regardless of its use. The statement in the notice, nevertheless, is that the corporation owns or leases land used for farming. It is possible a corporation owns or leases land within a county that is not used for farming, but the required notice will lead readers to believe the firm controls farmland within the county.

The initial report form does not allow adequate space for the incorporators to specify the relationships among all shareholders. A better format for the report would be to have the incorporators complete a table which clearly indicates all the relationships.

Assume a corporation with five shareholders: 1) Dad; 2) his spouse, Mom; 3) Dad's first cousin, Fred; 4) Dad and Mom's son, Joe; and 5) Dad and Mom's grandson, Jack. If the present question on the initial report form is answered with this information, it may look like this:

<u>Name</u>	<u>Address</u>	<u>Kinship</u>
Dad	Hometown, ND	
Mom	Hometown, ND	Spouse
Fred	Hometown, ND	First Cousin
Joe	Hometown, ND	Son
Jack	Hometown, ND	Grandson

This only indicates each shareholder's relation with dad but not with any other shareholder. This corporation may appear legal but it is not. Joe is Fred's first cousin once removed--a relationship not permitted by the statute--but this is not obvious from the reported information. The suggested format (Table 2) would indicate all relationships and, as shown, only half of the table needs to be completed.

TABLE 2. SUGGESTED FORMAT FOR A TABLE IN THE CORPORATE FARM REPORT FOR INDICATING THE RELATIONSHIPS AMONG ALL SHAREHOLDERS

	Dad	Mom	Fred	Joe	Jack
Dad	-				
Mom	2	-			
Fred	7	7*	-		
Joe	1	1	8	-	
Jack	5	5	8	1	-

Key: 1 Parent/Child 6 Great Grandparent/Great Grandchild
2 Spouse 7 First Cousin
3 Sibling * Spouse of Person so Related
4 Uncle-Aunt/Nephew-Niece 8 All Others and Violates the Statute
5 Grandparent/Grandchild

The initial report requires that one shareholder be actively engaged in operating the farm, unlike the requirement of an operating corporation that all officers and directors must be actively engaged in operating the farm. It appears, therefore, that the corporation has until the due date of the first annual report to be sure that all directors and officers are actively engaged in operating the farm. This statement must also include that at least one shareholder is an individual residing on or operating the farm. The second part of this reporting requirement may need to be amended to maintain consistency if the corresponding requirement is changed; that is, to require the individual shareholder to operate the farm, not just reside on it.

H.2. Annual Report

The second report farm corporations are required to file is the annual report.³⁹ This report is different than the annual report for business corporations⁴⁰ and is generally considered to substitute for the business corporation report rather than require an additional report. The statute does not explicitly state this, but this is how it is being applied.⁴¹ An argument in support of this interpretation would be as follows: the farm corporation law and business corporation law are in conflict in that each requires an annual report; and since the statute explicitly states that the farm corporation law takes precedence on conflicting points,⁴² farm corporations need to file only the annual report for corporate farming.

The annual reports are to be filed with the Secretary of State prior to April 15 for the year ending the preceding December 31. The specific requirements of the report are easy to understand except two--subsections 5 and 6. These two subsections are incomprehensible at best.

The requested information could be better understood if the numerated subsections of Section 10-06-08 NDCC were rewritten as follows:

- 1) Name and address of registered office of the corporation.
- 2) Name and address of the registered agent.
- 3) Name and address of officers and directors and whether each is actively engaged in operating the farm.
- 4)
 - A. Name and address of each direct shareholder, the number of shares owned by each and whether they are individuals, trusts, or estates.
 - B. Name and address of beneficiaries of shareholding trusts and estates, which beneficiaries are also direct shareholders, and percent of the trust or estate each beneficiary is entitled to.
 - C. Names of all individuals currently with either direct or indirect ownership interest in the corporation, whether each is a citizen or permanent resident alien of the United States, and who are operating (or residing on) the farm.
 - D. The relationships among all direct shareholders, beneficiaries of trusts, and decedent of stock-owning estates.
 - E. Names and addresses of all persons who owned stock during the past year but were no longer a shareholder on December 31.

- 5) Description and acreage of all land owned or leased by the corporation and used for farming or ranching listed by section, township, range, and county.
- 6) Percent of gross receipts derived the past year from passive income sources.
- 7) Percent of gross income derived from farming for the last five years or since incorporation, whichever is shorter.

The annual report form would need to be changed in accordance with statutory changes. A suggested report format is included as Appendix C, which uses as much as possible of the current reporting form, which is shown in Appendix B. This reporting form may be somewhat more complicated than the current format but it will provide the desired information and is understandable with minimum of explanation.

This suggestion includes several changes intended to clarify the statute without altering the underlying assumptions or objectives. First, the statute would no longer request information about shareholders who are "actively engaged in farming"--an additional and confusing term due to its similarity with "actively engaged in operating the farm" and its lack of definition. The Secretary of State had already interpreted the phrase to mean "operating" (see Question 6, annual report, Appendix B). The statute would use only "operating" rather than continuing to use both terms.

Second, these changes would delete reference to residing on the farm for directors, officers and the individual shareholder. This change would align report requirements for officers and directors with the statute's overall requirements. Furthermore, the language in parentheses should be deleted if the statute is amended to eliminate the alternative for an individual shareholder to reside on the farm rather than operate it (Page 13).

Third, the statute is clarified that beneficiaries of trusts and estates must be citizens or permanent resident aliens of the United States. Fourth, the reporting requirements continue the idea that beneficiaries of estates do not need to be related to all other shareholders (but the decedent must have been a related shareholder) and that the total number of individuals with ownership interest in the corporation cannot exceed 15 whether or not the individuals have to meet the relationship requirement.

Fifth, the corporation would no longer have the alternative of describing ownership interest in terms of percent of land used by the corporation. This clarifies the reporting requirement and is consistent with the reasoning of the 1983 legislature in deleting "members" of farm corporation from the statute. During the 1983 session, the Secretary of State testified that farm corporations as contemplated by the statute would not have members.⁴³ Extending this reasoning, there is no reason

why ownership interest cannot be expressed in terms of number of shares since farm corporations are expected to have only shareholders.

Sixth, the relationships among all shareholders can be presented in a table similar to the one suggested for the initial report (see page 17). Seventh, the corporate report must include a statement as to the percent of gross income the corporation derived from farming since its inception or for the past five years, whichever is shorter.

Finally, the report requires a listing of all natural and artificial persons who were shareholders sometime during the preceeding year but do not have indirect or direct ownership interest at the end of the year. This information should identify whether more detail about former shareholders is needed. In addition, the law requires the corporation to maintain a record of all transfers of shares or interest in the corporation.⁴⁴ This record must include the names of the transferor and transferee, their relationship, the number of shares transferred, and the date of the transfer. Maintenance of this record is mandatory even though the information is not filed as part of the annual report. An implicit assumption is that the annual report will be completed with information as of December 31 of the preceding year.

IV. Coal Mining Operations and Related Energy Conversion

The fourth exception to the general prohibition was created in 1983 to clarify that coal companies may own or lease land used for farming as long as the land is reasonably necessary in the conduct of the corporation's business.⁴⁵ This exception is available to corporations engaged in surface coal mining operations and related energy conversion. After the necessity for such land expires, the corporation must dispose of the land or be subject to the enforcement provisions discussed above.

Several observations can be made with respect to this exception. First, the exception and its termination will most likely be on a tract-by-tract basis rather than a company-wide basis. The exception would not terminate until all farmland held by the coal company is no longer necessary if the exception was on a company-wide basis. Consequently, the exception would last for years, well after the need has expired for tracts of land that already have been mined. If the exception is on a tract-by-tract basis, however, coal companies would be allowed to own or lease only land reasonably necessary at the time and forced to dispose of a tract when it is no longer needed.

Second, in order for the exception to apply, the land must be reasonably necessary in the conduct of the business; that is, the tract of land must be needed in the actual coal mining or related energy conversion operations. Legislative history suggests that the necessity continues throughout the reclamation and bond period.⁴⁶ Therefore, coal mining corporations may continue to lease or own mined land for 10 years after initial planting for revegetation of reclaimed areas.⁴⁷

Third, this exception, like the general prohibition, addressed only land "used for farming" rather than land "used or usable for farming." This exception also will need to be amended if the general prohibition is amended to encompass land usable for farming though not currently being used for that purpose.

V. Tax-Exempt Nonprofit Organizations

The fifth exception to the general prohibition was enacted by the 1983 legislature⁴⁸ and is intended to permit certain tax-exempt nonprofit organizations and trusts to own or lease land used for farming. An even more limited group of tax-exempt nonprofit organizations will be allowed to continue operating their existing farm activities. This exception was not easily passed (see page 4) and most likely will be addressed again by the legislature.

The nonprofit exception is available for two broad groups.⁴⁹ The first group is organizations exempt from taxation under Section 501(c)(3) of the Internal Revenue Code. Organizations under this section are usually corporations; they do not have to pay income tax on their proceeds; and more importantly, individuals who contribute money or property to these charitable organizations are entitled to a deduction for income, gift, or estate tax purposes. These organizations are recipients of gifts or bequests made in attempt to reduce tax liability. Consequently, nonprofit corporations (organizations) own farmland as a result of estate planning strategies which encourage individuals to consider contributing all or part of their interest in land to 501(c)(3) organizations. Partial interests in land are often contributed in the form of a remainder interest to the organization or a lead trust with the present interest for the benefit of a charity. Without a statutory exception, these organizations would be in violation of North Dakota corporate farming law. Furthermore, estate planning would be unduly restricted and further complicated in addition to frustrating existing plans. The second group is trusts whose beneficiaries are individuals related to one another within the degrees of kinship required for shareholders of family farm corporations.

These two groups may own or lease farmland as long as the land is leased to persons actually engaged in farming.⁵⁰ Permitting the organizations and trusts to lease farmland and yet requiring them to lease to persons engaged in farming allows these organizations and trusts to act as land brokers. There is no reason to grant an exception for anything other than ownership.

A. 501(c)(3) Organizations

It is important to note that not all nonprofit organizations meet the requirements of 501(c)(3). Examples of nonprofit organizations not included under 501(c)(3) are civic leagues operated for promotion of

social welfare; employee associations devoted to charitable, educational or recreational purposes; labor and agriculture organizations; business leagues and chambers of commerce; fraternal societies operated under the lodge system; teacher retirement funds; cemetery companies; and mutual credit unions.⁵¹ 501(c)(3) status is granted only to corporations, community chests, funds or foundations operated exclusively for religious, charitable, scientific, literary, or educational purposes as long as no substantial part of the activities is carrying on propaganda or otherwise attempting to influence legislation.⁵² There are about 5,540 nonprofit organizations in North Dakota with approximately 15 percent having received 501(c)(3) status.⁵³

Organizations under 501(c)(3) are 1) limited to acquiring farmland by gift and bequest and 2) required to dispose of farmland acquired after January 1, 1983 within 15 years of having acquired ownership in fee.⁵⁴ Acquisition is limited to accepting gifts and bequests in order to prevent 501(c)(3) organizations from purchasing farmland. Fee interest in property means the owner's interest is potentially infinite in duration; that there is no condition in the title which will force a mandatory divestiture. Restated, the 15-year period will apply only 1) if the organization receives all the interest in the land or 2) when a future interest becomes possessory.

Limitations on method of acquisition and term of ownerships will expire on June 30, 1985. This was a compromise reached during the 1983 session and is expected to incite the 1985 legislature to again consider farmland ownership by nonprofit organizations with the benefit of more time and possibly an interim study by the Legislative Council. If this subsection is allowed to expire, nonprofit organizations will not be required to dispose of farmland after 15 years of fee ownership. In addition, the implications for 501(c)(3) organizations acquiring farmland are not explicit. The general prohibition addresses ownership of land and not acquisition. The nonprofit organization exception, however, overrides the general prohibition and allows these organizations to own farmland. After expiration of this subsection, the statute no longer addresses acquisition. This should be interpreted to mean 501(c)(3) organizations will not be prohibited from acquiring and retaining ownership of farmland after that point in time.

B. Trusts

The restrictions on method of acquisition and duration of ownership do not apply to trusts defined by the nonprofit organization exception. This raises the question of why trusts are included in the exception. One explanation would be that the exception allows some trusts (those with corporate trustees) to own farmland that otherwise would be prohibited from doing so. Restated, the statute prohibits corporations from owning farmland or operating a farm business, and without this exception, trusts with corporate trustees are prohibited from owning farmland or operating a farm. Trusts with individual trustees, on the other hand, are not prohibited from owning farmland or

operating a farm by either the corporate farming law⁵⁵ or the statutes that set forth the powers of trusts.⁵⁶ Therefore, the only result of including trusts in the nonprofit exception is to permit trusts with corporate trustees to own farmland as long as all beneficiaries are related individuals and the land is leased to a person engaged in farming. This reading of the statute, however, does not alter the suggestion that the law should allow trusts with corporate trustees to own stock in a family farm corporation in order to avoid further complicating estate planning (see page 9).

The Legislative Council prepared a background paper on corporate farming as a preliminary step in preparation for the 1985 legislature. The paper concludes with several questions; the last one asks, "Could a trust, established by a farmer, operate the farm as a trust after the farmer dies?" The answer appears to be determined according to whether the trustee is a corporation or an individual. A corporate trustee, as discussed in the preceding paragraph, is prohibited from operating a farm business. Trusts with individual trustees, however, are not within the scope of the corporate farming statute and should be allowed to operate a farm. The ramifications of this question are discussed in a later section (see Implications, page 25).

Even though the description of trusts permitted to own farmland is the same as the one for trusts which may own stock in a family farm corporation, the implications are different. A trust under the nonprofit organization exception owns the land but must lease it to an actual farmer; under the family farm exception, the trust owns stock and has the duties and privileges of a shareholder.

Shareholders cannot, under either exception, give or bequeath stock in a family farm corporation to a nonprofit organization. The nonprofit exception allows 501(c)(3) organizations to own farmland, not stock in a family farm corporation. Furthermore, only individuals, trusts and estates are allowed to own stock of a family farm corporation. Use of a trust will not resolve this situation because both exceptions require all beneficiaries to be individuals.

Farmland, likewise, cannot be contributed to 501(c)(3) organizations through the use of a trust. This, however, may not present a problem since it is easier, with respect to federal tax law, to contribute land directly to charities rather than using a trust.⁵⁷

C. Grandfather Clauses

The legislature included two additional but narrow exceptions. First, 501(c)(3) organizations which own farmland "for the preservation of unique historical, archaeological or environmental land prior to January 1, 1983" do not have to sell. This exception allows the Cross Ranch to continue owning its farmland.⁵⁸

The second exception allows 501(c)(3) organizations that actually farmed before January 1, 1983 to continue to farm (rather than having to lease out the land) as well as not being required to sell. Specific organizations affected by this provision include Assumption Abbey and Dakota Boys Ranch.⁵⁹

The law is not clear, however, whether these farm operations can be expanded by either purchase or lease of additional land, or whether different land can be acquired if part of the existing operation is disposed of or is no longer available for farming. The acquisition limitation, even though it may be allowed to expire, most likely will be interpreted to mean that until June 30, 1985, 501(c)(3) organizations permitted to farm will be able to expand their land holdings only through gifts. In addition, the statute gives no indication how the second question will be resolved, but if the answer is no, these organizations will again have to rely on gifts to replace acreage no longer available for farming.

VI. Industrial and Business Purpose

The sixth exception to the general prohibition was also enacted by the 1983 legislature but was not codified in the North Dakota Century Code because the section will expire on June 30, 1985. This is the same date on which some of the nonprofit organization limitations also will expire. The expiration is intended to encourage the 1985 legislature to again address some unresolved issues.

This exception allows a nonfarm corporation to own or lease farmland as long as the land is necessary for residential or commercial development, or siting of buildings, plants, facilities, industrial parks, and similar business or industrial purposes of the corporation.⁶⁰ Farmland also can be acquired if its use will support or be ancillary to adjacent nonagricultural land and both parcels will benefit by having the farmland controlled by the nonfarm corporation. The land must be available for persons actually engaged in farming to lease when it is not being used by the nonfarm corporation.

Nonfarm corporations will again be prohibited from acquiring farmland for developmental purposes if this exception is allowed to expire. This would stifle conversion of farmland to nonagricultural purposes except by noncorporate persons. This exception, like the surface coal mining provision, partially replaces the "reasonably necessary" exemption of the pre-1981 law that was deleted by the 1981 changes.

It was suggested earlier that the general prohibition be broadened to encompass all land usable as well as used for farming (see pages 5 and 6). With the general prohibition in its current form, nonfarm corporations acquiring land for development would not need to take any action with respect to the land except to convert its use from farming (perhaps to growing grass intending not to harvest) or have an acceptable operator conduct a farming operation. If the general prohibition is broadened, however, the nonfarm corporation would be limited to either developing the land (so that it would no longer be considered usable for farming) or leasing it to an acceptable operator. Continuation of the industrial-business exception coupled with a broadening of the general prohibition would prevent corporations from acquiring farmland intending not to develop or farm it for several years. The two ideas should be viewed as complements rather than contradictory.

VII. Implications

There are unanswered questions with respect to the corporate farming law. This is clearly evinced by the 1983 legislative session which included a governor's veto, differing opinions among legislators, enactment of stop-gap measures and a study resolution. The Legislative Council raised, among others, the following questions: "Can a partnership operate a farm? Would it make a difference if it is a general partnership with only two general partners or a limited partnership with two general partners and 150 limited partners?" These simple questions imply key issues; why have corporations been targeted for regulation and are there other entities that should be regulated as well? Answers to these questions lie in the attitude of North Dakota's citizens.

It is not clear whether there has been a change in attitude toward corporate ownership and operation of farmland. The current statute is similar to prior law. Three explicit exceptions were continued: cooperative corporations, reasonable necessity for nonfarm corporations even though the exception is somewhat more restrictive, and farmland acquired through process of law such as foreclosure of liens or mortgages. The statute was changed to allow families to incorporate the ownership and operation of their farmland, but those who operated as a corporation prior to the change often were not prosecuted. The current statute also includes an exception for nonprofit corporations although these organizations have owned farmland in the past. Lack of enforcement of the prior statute as well as absence of pressure to prosecute violators may indicate that family farm and land-owning nonprofit corporations are accepted, not just tolerated, by North Dakota citizens. Attitudes prior to recent amendments must have been similar to current attitudes and the statute was changed merely to reflect more accurately an attitude that has prevailed for some time.

North Dakota's corporate farming statute is based on the assumption that some entities have characteristics which deem it desirable to regulate their ownership and operation of farmland.

Regulation is desirable in these cases because anticipated results of uncontrolled acquisition and ownership of farmland are considered unacceptable. The Legislative Council is asking the citizens of North Dakota, through their legislators, to restate their concerns, to identify what results are unacceptable and suggest characteristics of entities that would cause these results. These questions may be broader than the study resolution, but the responses would be extremely helpful in drafting legislation even if it only addresses the nonprofit exception.

One approach to answering this inquiry is to take the following steps:

- 1) Restate the perceived problem; that is, what are considered unacceptable results
- 2) Identify the goal of regulation by determining what causes the unacceptable results. This assumes the goal of the law is to regulate the causes
- 3) Identify characteristics of entities likely to cause the unacceptable results
- 4) Identify types of entities with these characteristics
- 5) Answer these questions:
 - A) Should all these entities be regulated?
 - B) What should be the qualitative definition of the entities to be regulated?
 - C) Which of these entities are already regulated?
 - D) Which entities cannot be regulated because of legal limitations such as those provided for in our constitutions?
 - E) Are there exceptions; that is, are there some entities that 1) possess the suspect characteristics but do not produce the unacceptable results or 2) produce benefits sufficient to outweigh the unacceptable results? Political pressures probably will influence the response to this question because determination of unacceptable results and benefits will likely evolve into a policy decision.

This approach of concentrating on characteristics of entities may be somewhat different in that it does not assume "corporations generally should be prohibited from owning farmland whereas ownership by other types of organizations is acceptable." Instead, characteristics that are expected to produce unacceptable results are identified, and

organizations other than corporations could possess these characteristics. This is similar to the question asked by the legislative council.

The current Kansas law recognizes this by including trusts in its general prohibition. North Dakota's statute, however, does not address trusts with noncorporate trustees nor noncorporate nonprofit organizations. In addition, an argument could be made that trusts with corporate trustees are not within the scope of the general prohibition even though that argument would likely fail. The argument, nevertheless, would be that a corporate trustee holds only the legal title to the property with the equitable title held by the beneficiaries; in other words, the trustee is not "the" owner and, therefore, is outside the scope of the general prohibition.

Kansas explicitly prohibits corporate partnerships and limited corporate partnerships (that is, general and limited partnerships that have corporations as one or more of the partners) from owning agricultural land. These partnerships might argue they are permitted by North Dakota's statute to own farmland and engage in farming irrespective of the fact that a corporation is one of the partners. The argument would be that the general prohibition applies only to corporations, which they are not; that partnerships can own farmland; and that corporations can be partners.⁶¹ The only argument against corporate partnerships would be that the corporate partners are engaged in farming, an activity prohibited by the corporate farming statute. Furthermore, the corporation would have to materially participate in the farm operation or it would be in trouble with the Internal Revenue Service due to the personal holding company tax. A corporate partnership would be a way to circumvent the prohibition if the corporation is materially participating (a level of activity) but not engaged in farming (because the partnership is the entity that is engaged in farming). On the other hand, the legislature should remember it is easier to explicitly answer a question or resolve an ambiguity rather than forcing the courts to reconcile the legislature's probable intent with the language of the statute.

The idea of identifying characteristics is not new. The 1932 initiated measure provided an exception for cooperative corporations with certain characteristics, such as having "75 percent of the shareholders as actual farmers residing on the farm or depending principally on farming for their livelihood." Testimony presented at hearings during the 1981 legislature included descriptions of undesirable characteristics: outside owners, larger-than-family size, possess artificial competitive advantages, organizations that speculate in farmland, and owning land just to use as a tax write-off. Entities, other than corporations, must possess these characteristics. The Kansas statute is along this same line of thought in that it provides an exception for corporations if "at least 30 percent of the shareholders reside on or are actively engaged in day-to-day labor or management of the farming operation." Defining characteristics of entities could be a more appropriate approach in describing which entities are regulated.

Rather than exempting all 501(c)(3) organizations, why not consider providing an exception for nonprofit corporations that spend a specified percentage of their annual revenue derived from within the state for the benefit of North Dakota or its citizens? Such a criterion would have to provide an allowance for exceptional years. Perhaps the percentage should be calculated using data from several most recent years, similar to the income limitations for domestic family farm corporations. Regardless of what the final exception may be, discussion and exchange of ideas would be easier if they are in terms of "objectives of the statute" and "characteristics of organizations" rather than types of organizations.

VIII. Summary

North Dakota statutory law for half a century explicitly prohibited corporations from engaging in the business of farming and implicitly prohibited them from owning farmland. The 1981 and 1983 legislative sessions amended the statute to allow families to incorporate their farm businesses. Complexities and emotions surrounding this topic, however, will cause it to be reviewed again by the 1985 legislature. This paper presents suggestions for consideration by the upcoming legislature.

North Dakota's corporate farming statute continues to prohibit corporations from owning land used for farming and from engaging in the business of farming. The 1981 legislature provided three exceptions to this general rule:

- 1) Cooperative corporations are excepted if 75 percent of its members or shareholders are actual farmers residing on the farm or depending principally on farming for their livelihood.
- 2) Domestic family farm corporations may own farmland as well as engage in the business of farming if they meet the requirements of the statute.
- 3) Corporations which acquire farmland by process of law in the collection of debt or enforcement of a lien or claim may own it for three years.

The 1983 legislature added three more exceptions:

- 1) Corporations conducting surface coal mining or related energy conversion may own or lease land used for farming.
- 2) Tax-exempt nonprofit corporations and certain trusts may own or lease farmland and certain tax-exempt nonprofit corporations may continue to engage in farming if they were doing so on January 1, 1983.

- 3) Corporations may own or lease land used for farming if the land is necessary in developing nonagricultural uses.

The 1985 legislature intends to review the tax-exempt nonprofit and the development exceptions. That may be an opportunity for it to consider the entire statute and some of the remaining questions with respect to the other exceptions, especially the family farm exception. Points that need clarification are:

- 1) Whether adopted persons or half-blood relatives will be treated the same as full-blood relatives;
- 2) The definition of an "eligible" person for purposes of protecting minority shareholders;
- 3) Whether beneficiaries of trusts permitted to own shares of family farm corporations are required to be related to just one shareholder or to all shareholders;
- 4) Whether the decedent of an estate that owns shares in a family farm corporation had to be a shareholder;
- 5) Whether beneficiaries of trusts are required to be either citizens or permanent resident aliens of the United States;
- 6) What is meant by "actively engaged in operating the farm," "operating the farm," and "actually engaged in farming."
- 7) The definition of gross income and gross receipts;
- 8) What method should be used to compute whether 65 percent of the corporation's gross income has been derived from farming operations;

The annual report for family farm corporations may be more functional if the statute is clarified as to what information is desired and the report form is changed to facilitate reporting that information. Two additional changes which would more closely align the statute with its purported purpose would be: 1) to have the general prohibition apply to land usable for farming as well as land used for farming, and 2) to replace the residency requirement for one individual shareholder with a requirement that a specified percent of the corporation's stock be owned by shareholders operating the farm business. These two suggested changes are very similar to the pre-1981 statute and the cooperative corporation exception.

Finally, in deciding whether ownership of farmland should be restricted, it would be helpful to discuss the topic in terms of the "objective of the statute" and the "characteristics of entities" rather than the type of entity.

FOOTNOTES

1. Family Farm and Cooperative Corporation Exceptions of North Dakota Corporate Farming Statute, Agricultural Economics Miscellaneous Report No. 71, North Dakota State University, Fargo, February 1984.
2. 1933 North Dakota Session Laws p. 494.
3. McElroy, T.P. "North Dakota's Anti-Corporate Farming Act," North Dakota Law Review, 36:2, 96-103, 1960.
4. Coal Harbor Stock Farm v. Meier, 191 NW2d 583 (1971).
5. 1933 North Dakota Session Laws ch. 89.
6. 1935 North Dakota Session Laws ch. 111.
7. Bureau of the Census, 1978 Census of Agriculture, United States Department of Commerce, Vol. 1, Part 34, p. 31.
8. McElroy, note 2, supra; Harl, Neil E. Agricultural Law, Matthew Bender, New York, NY, 1983, S 51.04 (2).
9. 1967 North Dakota Session Laws ch. 97.
10. 1969 North Dakota Session Laws ch. 580.
11. 1975 North Dakota Session Laws ch. 601.
12. North Dakota Century Code (NDCC) §10-06-01.
13. NDCC § 10-06-04.
14. NDCC § 10-06-07.
15. NDCC § 10-06-13.
16. NDCC § 10-06-01.2.
17. North Dakota Legislature, Journal of the House, 1983, p. 2035.
18. Ibid., pp. 2507 and 2529.
19. 1983 North Dakota Session Laws ch. 131.
20. 1983 North Dakota Session Laws ch. 809, House Concurrent Resolution No. 3100.
21. NDCC § 10-06-01.
22. 1933 North Dakota Session Laws p. 494.

23. Loy v. Kessler, 39 NW2d 260, 272 (1949).
24. NDCC § 10-06-07.
25. NDCC § 10-06-07 (2).
26. NDCC § 10-06-15.
27. NDCC § 10-19-49 "Officers ... Any two or more offices may be held by the same person, except the offices of the president and secretary."
28. NDCC § 10-19-37.
29. Office of Attorney General, State of North Dakota, opinion 81-135, December 23, 1981.
30. NDCC § 10-06-07.1.
31. NDCC § 10-06-07.2.
32. Committee Hearing, January 23, 1981; Eugene Nicholas, Chairman, House Committee on Agriculture, personal communication, March 26, 1981, copy of letter on file in Agricultural Economics Department, North Dakota State University.
33. United States v. National Dairy Products, 372 US 29, 32 (1963).
34. NDCC § 10-06-07.
35. North Dakota Stockmen's Association, resolution, 1983 annual meeting.
36. North Dakota Legislature, Senate Agriculture Committee, 1981.
37. NDCC § 10-06-07.3.
38. NDCC § 10-06-08.
39. NDCC § 10-06-08.
40. NDCC § 10-23-01.
41. Office of Attorney General, personal communication.
42. NDCC § 10-06-07.1.
43. Secretary of State, testimony before House Agriculture Committee, March 3, 1983.

44. NDCC § 10-06-08.
45. NDCC § 10-06-01.2.
46. Legislative Council, "Explanation of House Bill 1563," legislative history on House Bill 1563, 1983.
47. NDCC §§ 38-14.1-24 (18) and 38-14.1-17 (7).
48. NDCC § 10-06-04.1.
49. NDCC § 10-06-04.1 (1).
50. Ibid.
51. 26 United States Code (U.S.C.) § 501.
52. 26. U.S.C. S 501 (c)(3).
53. Internal Revenue Service, personal communication, Division of Exempt Organizations, Minneapolis Office.
54. NDCC § 10-06-04.1 (4).
55. NDCC § 10-06-01.
56. NDCC Title 59.
57. Harl, note 8 supra, S 44.04 (3)(D).
58. NDCC § 10-06-04.1 (3).
59. NDCC § 10-06-04.1 (2).
60. 1983 North Dakota Session Laws ch. 131 (7).
61. NDCC §§ 45-05-01 and 45-05-05.

APPENDIX A
Initial Report for
Corporate Farming or Ranching

1. Name of the
operation
2. Location
3. Date

4. Description of the operation
5. Description of the land
6. Description of the equipment

7. Description of the personnel
8. Description of the financial situation

9. Description of the production
10. Description of the marketing

11. Description of the management
12. Description of the future plans

13. Description of the risks
14. Description of the opportunities

15. Description of the conclusions
16. Description of the recommendations

17. Description of the appendix
18. Description of the references

19. Description of the index
20. Description of the glossary

21. Description of the bibliography
22. Description of the appendix

23. Description of the references
24. Description of the index

25. Description of the glossary
26. Description of the bibliography

27. Description of the appendix
28. Description of the references

29. Description of the index
30. Description of the glossary

31. Description of the bibliography
32. Description of the appendix

33. Description of the references
34. Description of the index

35. Description of the glossary
36. Description of the bibliography

37. Description of the appendix
38. Description of the references

39. Description of the index
40. Description of the glossary

41. Description of the bibliography
42. Description of the appendix

43. Description of the references
44. Description of the index

45. Description of the glossary
46. Description of the bibliography

47. Description of the appendix
48. Description of the references

49. Description of the index
50. Description of the glossary

51. Description of the bibliography
52. Description of the appendix

53. Description of the references
54. Description of the index

55. Description of the glossary
56. Description of the bibliography

57. Description of the appendix
58. Description of the references

59. Description of the index
60. Description of the glossary

61. Description of the bibliography
62. Description of the appendix

63. Description of the references
64. Description of the index

65. Description of the glossary
66. Description of the bibliography

67. Description of the appendix
68. Description of the references

69. Description of the index
70. Description of the glossary

71. Description of the bibliography
72. Description of the appendix

73. Description of the references
74. Description of the index

75. Description of the glossary
76. Description of the bibliography

Appendix A

Initial Report for Corporate Farming or Ranching

- 34 -

THE UNITED STATES OF AMERICA
DEPARTMENT OF AGRICULTURE

WASHINGTON, D. C.
20250

OFFICE OF THE SECRETARY
WASHINGTON, D. C.
20250

ANNUAL REPORT FOR
CORPORATE FARMING OR RANCHING

THE UNITED STATES OF AMERICA
DEPARTMENT OF AGRICULTURE

WASHINGTON, D. C.
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OFFICE OF THE SECRETARY
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ANNUAL REPORT FOR
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THE UNITED STATES OF AMERICA
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OFFICE OF THE SECRETARY
WASHINGTON, D. C.
20250

Appendix B

Annual Report for Corporate Farming or Ranching

ANNUAL REPORT FOR
CORPORATE FARMING OR RANCHING

To: Secretary of State
Capitol Building
Bismarck, ND 58505

File No. _____
Receipt _____

Pursuant to the provisions of Section 10-06-08 of the North Dakota Century Code, the undersigned hereby submits the following report:

1. The name of the corporation is _____
2. The place (county) of its incorporation is _____
3. The address of its registered office in the State of North Dakota is _____

_____. The name and address of the registered agent is _____

4. The acreage (hectarage) owned or leased by the corporation and used for farming and ranching is located as listed:

Acreage	Section	Township	Range	County
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

(Attach additional sheet if necessary.)

5. The names and addresses of the officers and directors are as follows:

NAME	ADDRESS	OFFICE	DIRECTOR	ACTIVELY ENGAGED IN OPERATING FARM OR RANCH	RESIDING ON FARM OR RANCH
_____	_____	President	[]	[]	[]
_____	_____	Vice Pres.	[]	[]	[]
_____	_____	Secretary	[]	[]	[]
_____	_____	Treasurer	[]	[]	[]
_____	_____	Director		[]	[]
_____	_____	Director		[]	[]
_____	_____	Director		[]	[]

If the officers are also directors, please check the column marked "Director". If the officers or directors are actively engaged in operating or residing on the farm or ranch, check the appropriate column.

6. The number of shares of stock (or percentage of interest in the owned or leased acreage) the corporation used for farming or ranching owned or leased by persons residing on and operating the farm or ranch is _____.

State of North Dakota
My Commission Expires

Appendix C
Suggested Revised
Annual Report for
Corporate Farming or Ranching

Annual Report

- *1. The name of the corporation is _____.
- *2. The place (county) of its incorporation is _____.
- *3. The address of its registered office in the state of North Dakota is _____.
- The name and address of the registered agent is _____.
- *4. The acreage (hectarage) owned or leased by the corporation and used for farming and ranching is located as listed:

Listed Acreage	Section	Township	Range	County
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

- *5. The names and addresses of the officers and directors are as follows:

Name	Address	Office	Director	Actively Engaged in Operating The Farm
_____	_____	Pres.	--	--
_____	_____	V. Pres.	--	--
_____	_____	Sec.	--	--
_____	_____	Treas.	--	--
_____	_____	Dir.		--
_____	_____	Dir.		--
_____	_____	Dir.		--

If the officers are also directors, please check the column marked "director." If the officers or directors are actively engaged in operating the farm or ranch, check the last column.

6. Complete the following table regarding direct shareholders; that is, those persons who own the stock according to the corporation's stock transfer books. Check the appropriate column (individual or trust/estate) and list the number of shares held by each direct shareholder.

[illegible]

7. Complete the following regarding shares held by trusts or estates. Present the information for each trust and estate on a separate table.

Name of trust or decedent

Provide the name and address for each beneficiary of the trust or estate. Indicate whether the individual is also a direct shareholder and the percent of interest of the trust or estate each beneficiary is entitled to. The percentages for each trust and estate should total 100.

[illegible]

- *11. The percentage of gross receipts the corporation derived from rent, royalties, dividends, interest, and annuities for the calendar year 19__, _____.
- 12. The percentage of gross income derived by the corporation from farming and ranching operations since incorporating or the last five years, whichever is shorter. _____

*Question is based on a question from the current annual report form.

**This information is sufficient should the legislature decide to delete the residency alternative for one individual shareholder and instead require that a specified percentage of the stock be directly or indirectly owned by individuals who are operating the farm.

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