

notes to make them a creditor rather than an owner of the corporation although the issuance of debt securities as part of a tax-free exchange is discouraged. For example, if the corporation is also capitalized with preferred stock or bonds, and these go to the parents or off-farm heirs, the amount of common stock the farming children need to gain control of the business is reduced.

Business continuity

A key feature of the corporation is business continuity. A corporation can be established to continue forever — or until it is dissolved by the owners or by operation of law. So the life of the corporation may transcend the life of individual members and is not disrupted by the death or withdrawal of a family member. This aspect of the corporation allows for a smoother transfer of the business from one generation to the next. However, this is no guarantee of success. The remaining corporate members must have the managerial skills to operate the business.

Limited liability

As a general rule, the liability of the shareholders is limited to their investment in the corporation. Limited liability becomes an important issue when the owner-operators have personal investments outside the business. However, there is no absolute guarantee of limited liability. Even the corporate shareholder may be subject to liability greater than his/her investment (or commitment to invest) if the shareholder assumes personal liability for debt obligations. This frequently occurs in farming when shareholders are asked to co-sign the corporation's loan agreements. Adequate liability and property insurance should be carried to protect the business capital. The liability issue should be checked carefully with your attorney.

Minority stockholders

The interests of majority stockholders may be different from those of minority stockholders. For example, the majority stockholders also may be

employees of the corporation. They may want to distribute the corporate income as salaries rather than dividends. The majority stockholders may vote against the interests of minority stockholders leaving them with little or no cash return on their investments. In addition, there may be little or no market for the stock of a closely-held corporation. Minority stockholders may be *locked in* unless their rights are specified in the articles of incorporation and by-laws, and buy-sell agreements are used to protect their investment.

Corporation control

Two key issues that arise at corporate formation are:

- what property should be put into the corporation; and
- what type of capital structure should be used?

If all the farm property is put into the corporation and the owners all receive common stock in return, the farming child must gain control of 51 percent of the total business assets to control the business.

An alternative would be to keep certain property out of the corporation. For example, the production side of the business could be incorporated with the land not included. This would reduce the amount of common stock the farming child would need to gain control. However, leaving the land out may not meet the estate planning objectives. So, holding the land in a limited partnership or trust may be used. Also, the production side of the business tends to be a heavy user of capital. Leaving the land out eliminates a very important source of collateral for borrowing.

Another alternative would be to place all the assets into the corporation, but use a capital structure that also includes preferred stock or debentures or both. This would reduce the amount of common stock needed to gain control of the business, while guaranteeing returns to minority stockholders.

Disadvantages

Generally, it costs more to set up and maintain a corporation. There also are some possible adverse tax consequences in the formation, operation, and dissolution of the corporation. At formation, a tax-free exchange is usually possible. Since the exchange of assets is normally tax free at formation, termination holds the potential for a large capital gains tax. Also, more formal record keeping is required of a corporation.

... and justice for all

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