



---

1982

### North Dakota's Corporate Farming Statute: An Analysis of the Recent Change in the Law

Ross H. Espeseth

Follow this and additional works at: <https://commons.und.edu/ndlr>



Part of the [Law Commons](#)

---

#### Recommended Citation

Espeseth, Ross H. (1982) "North Dakota's Corporate Farming Statute: An Analysis of the Recent Change in the Law," *North Dakota Law Review*: Vol. 58 : No. 2 , Article 3.

Available at: <https://commons.und.edu/ndlr/vol58/iss2/3>

This Note is brought to you for free and open access by the School of Law at UND Scholarly Commons. It has been accepted for inclusion in North Dakota Law Review by an authorized editor of UND Scholarly Commons. For more information, please contact [und.common@library.und.edu](mailto:und.common@library.und.edu).

## NOTE

### NORTH DAKOTA'S CORPORATE FARMING STATUTE: AN ANALYSIS OF THE RECENT CHANGE IN THE LAW

#### I. INTRODUCTION

On March 30, 1981, North Dakota Governor Allen Olson signed Senate Bill 2233,<sup>1</sup> thereby changing the law that had been in effect since 1932.<sup>2</sup> The new law permits North Dakota farmers and ranchers to incorporate as long as they follow the requirements set forth in the statute.<sup>3</sup> Unlike the last attempt to end the prohibition of corporate farming, this bill was not referred to the voters of North Dakota.<sup>4</sup> As a result, the new law became effective July 1, 1981.<sup>5</sup>

This Note will analyze the new statute in an attempt to

---

1. 1981 N.D. Sess. Laws ch. 134.

2. 1933 N.D. Sess. Laws 494. The original corporate farming bill was amended twice. *Id.*, amended by 1933 N.D. Sess. Laws ch. 89 and 1935 N.D. Sess. Laws ch. 111. It was revised in 1943. N.D. REV. CODE §§ 10-0601 to -0606 (1943) (repealed 1981).

3. The legislative history of the statute indicates that the bill was passed to allow farmers and ranchers to use incorporation as a business tool to increase the return on their investments. *Hearings on Senate Bill No. 2233 Before the Senate Agricultural Comm.*, 47th N.D. Leg. Assembly (January 29, 1981) (comments of Sen. Iszler, co-sponsor of the bill) [hereinafter cited as *Senate Agricultural Hearings*]. Also, the Act was intended to help preserve the family farm. *Id.* (comments of Rep. Olafson).

4. In 1967 a corporate farming bill was referred to the voters of North Dakota and defeated by a vote of 171, 321 to 53,938. 1969 N.D. Sess. Laws 1238.

5. N.D. CONST. art. IV, § 41. There was an attempt to attach an emergency amendment to the bill which would have made the bill effective upon the governor's signing of it. *Senate Agricultural Hearings*, *supra* note 3 (February 12, 1981) (amendments). This amendment, however, was removed before the final form was submitted to Governor Olson. *Hearing on Senate Bill No. 2233 Before the House Agricultural Comm.*, 47th N.D. Leg. Assembly (March 17, 1981) [hereinafter cited as *House Agricultural Hearings*].

determine if it will meet the expectations of those who supported it. In order to accomplish this, the history of corporate farming in North Dakota will be presented. This will be followed by an analysis of each section of the corporate farming bill using the legislative history, other states' statutes, and commentaries by other writers concerning corporate farming. The final section will discuss the implications and ramifications of the North Dakota statute.

## II. THE HISTORY OF CORPORATE FARMING IN NORTH DAKOTA

North Dakota voters went to the polls in 1932 and approved a corporate farming bill by a vote of 114,496 to 85,932.<sup>6</sup> This corporate farming bill was instituted as an initiated measure<sup>7</sup> to protect North Dakota farmers from the effects of the nationwide depression occurring at that time.<sup>8</sup> Low prices had forced many farmers to borrow money to keep their farms operating. These loans were often secured by pledging the farms as collateral.<sup>9</sup> Continued low prices made it impossible for many of North Dakota's rural citizens to make their loan payments. Foreclosure by the lending institutions, many of which were corporations, followed.<sup>10</sup> North Dakota voters reacted by passing an initiated measure intended to allow North Dakota farmers to retain their land.<sup>11</sup>

The 1932 corporate farming statute contained three means of keeping North Dakota farm land in the possession of the small farmers and out of the control of the corporations. One was a prohibition on corporate ownership of more land than necessary for business purposes.<sup>12</sup> Additionally, corporations were prohibited

6. 1933 N.D. Sess. Laws 494, 495.

7. *Id.*

8. Although there is no legislative history concerning this initiated measure, other North Dakota writers have stated that this was the reason for the initiated measure. See McElroy, *North Dakota's Anticorporate Farming Act*, 36 N.D.L. REV. 96, 96 (1960); O'Keefe, *The North Dakota Anti-Corporate Farming Act: A Dissenting Opinion*, 41 N.D.L. REV. 333, 333 (1964); 44 N.D.L. REV. 255, 256-57 (1967).

9. 44 N.D.L. REV. at 256.

10. *Id.* at 256-57.

11. *Id.* at 257.

12. 1933 N.D. Sess. Laws 494, § 1. The initiated measure provided as follows:

That all corporations, both domestic and foreign, except as otherwise provided in this act, are hereby prohibited . . . from acquiring or holding real estate in excess of that necessary for the conduct of their business, unless the same is acquired in the course of their business by judicial process or operation of law.

*Id.* This section was amended and reenacted by the 1933 Legislative Assembly to omit the

from engaging in the business of farming or agriculture.<sup>13</sup> Finally, the statute provided for divestiture of land being held by a corporation in violation of the statute.<sup>14</sup>

The 1932 statutory scheme for protecting North Dakota farmers resulted in litigation challenging the statute.<sup>15</sup> In *Asbury Hospital v. Cass County*<sup>16</sup> the United States Supreme Court affirmed the decision of the North Dakota Supreme Court requiring a Minnesota corporation to divest itself of farmland situated in North Dakota.<sup>17</sup> The land was being leased to farmers at the time of the action.<sup>18</sup> The corporation's position was that it should not have to sell the land because the land could not be sold for a profit within the statutory ten year divestiture period.<sup>19</sup> The Supreme Court held that the forced sale was not a violation of either the due process clause<sup>20</sup> or the equal protection clause<sup>21</sup> of the fourteenth amendment. The Court reasoned that due process does not require that a profit be made; it requires only a fair opportunity to sell the land.<sup>22</sup> Likewise, equal protection was not violated because North Dakota had sufficient reason to require corporations to sell their land while at the same time allowing cooperatives to own land and engage in farming.<sup>23</sup> The commerce clause was not argued to the Court; therefore, that issue was left undecided.<sup>24</sup>

---

prohibition of corporate acquisition or holding of real estate in excess of that necessary for the conduct of business. *Id.* ch. 89, § 1.

13. 1933 N.D. Sess. Laws 494, § 1. The initiated measure provided "[t]hat all corporations, both domestic and foreign, except as otherwise provided in this act, are hereby prohibited from engaging in the business of farming or agriculture. . . ." *Id.*

14. *Id.* § 2. This provision of the initiated measure stated:

That all corporations, both domestic and foreign, who now own or hold real estate, except such as is reasonably necessary in the conduct of their business, shall dispose of the same within ten years from the date that this act takes effect, provided that during said ten year period said corporations may farm and use said real estate for agricultural purposes.

*Id.*

15. In general there is very little case law that concerns corporate farming.

16. 326 U.S. 207 (1945).

17. *Asbury Hosp. v. Cass County*, 326 U.S. 207, 212 (1945). The Court held that a state could exclude a foreign corporation from doing business or acquiring or holding property within it, even after it had first allowed the corporation to enter the state. *Id.* at 211.

18. *Id.* at 210. The corporation had acquired the land in satisfaction of a mortgage indebtedness before leasing the property to farmers. *Id.*

19. *Id.* at 212.

20. *Id.* The due process clause of the fourteenth amendment states, "nor shall any State deprive any person of life, liberty, or property, without due process of law. . . ." U.S. CONST. amend. XIV, § 1. According to the United States Supreme Court, due process does not require that a corporation be able to salvage the cost of its investment. 326 U.S. at 212.

21. 326 U.S. at 214. The equal protection clause of the fourteenth amendment states, "[n]o State shall . . . deny to any person within its jurisdiction the equal protection of the laws." U.S. CONST. amend. XIV, § 1. The Court held that a state can make classifications relevant to the legislative purpose of the statute. 326 U.S. at 214.

22. 326 U.S. at 212.

23. *Id.* at 214.

24. *Id.* at 210. For commentaries reasoning that the commerce clause is not violated by

The next case to reach the North Dakota Supreme Court challenging the 1932 corporate farming statute was *Loy v. Kessler*.<sup>25</sup> The defendants in this action claimed that the corporate farming statute prohibited the plaintiff corporation from taking title to the land in dispute because the corporate farming statute barred all corporations from taking title to any farmland except in limited circumstances.<sup>26</sup> The court held that the statute as amended in 1933 did not prohibit corporations from taking title to rural real estate.<sup>27</sup> The court reasoned that the 1932 statute as amended did not void conveyances of farmland to corporations; rather the statute was to be used as the basis for an action requiring corporations to divest themselves of real estate held in violation of the corporate farming statute.<sup>28</sup>

Dicta in *Loy v. Kessler* stating that a corporation may hold land indefinitely if reasonably necessary in the conduct of its business<sup>29</sup> led to the most recent corporate farming case to reach the North Dakota Supreme Court. In *Coal Harbor Stock Farms, Inc. v. Meier*<sup>30</sup> a group of farmers attempted to form a corporation for the purpose of farming.<sup>31</sup> The court held that the statute allows only cooperative corporations to engage in farming or agriculture.<sup>32</sup> The opinion stated that a corporation could not be established for the purpose of engaging in farming or agriculture.<sup>33</sup> The court further reasoned that a corporation could not have corporate powers for owning or holding land for the purpose of engaging in farming or agriculture because that corporate purpose was prohibited.<sup>34</sup>

In addition to interpretation of the North Dakota corporate farming statute by the courts, the state legislature modified the

anticorporate farming statutes see Morrison, *State Corporate Farm Legislation*, 7 U. Tol. L. Rev. 961, 980-87 (1976); Comment, *Proposed Anticorporate Farm Legislation*, 1972 Wis. L. Rev. 1189, 1211-12.

25. 76 N.D. 738, 39 N.W.2d 260 (1949).

26. *Loy v. Kessler*, 76 N.D. 738, 757, 39 N.W.2d 260, 270 (1949). *Loy* involved a quiet title action, but the defendants argued the intent of the corporate farming statute to the state supreme court. *Id.* at 757-62, 39 N.W.2d at 270-73.

27. *Id.* at 760, 39 N.W.2d at 272. The court rejected the argument that the statute prohibited corporations from acquiring title to farm land by implication. *Id.* at 760-61, 39 N.W.2d at 272-73. The majority reasoned that when the statutory language prohibiting the acquisition of title to rural real estate was deleted in 1933, the legislature intended to allow corporations to take valid title to real estate subject to the other sections of the statute. *Id.* at 761, 39 N.W.2d at 273 (construing 1933 N.D. Sess. Laws ch. 89, § 1).

28. *Id.* at 760, 39 N.W.2d at 272.

29. *Id.*

30. 191 N.W.2d 583 (N.D. 1971).

31. *Coal Harbor Stock Farms, Inc. v. Meier*, 191 N.W.2d 583, 585 (N.D. 1971). The court held that the secretary of state did not err in refusing to issue the certificate of incorporation because corporations were prohibited from engaging in the business of farming or agriculture. *Id.* at 588.

32. *Id.* at 588. The court reasoned that the corporate farming statute, when all the sections are construed together, prohibits all corporations except the cooperative corporations from engaging in the business of farming or agriculture. *Id.* at 587.

33. *Id.* at 587.

34. *Id.* at 587-88.

1932 corporate farming statute.<sup>35</sup> The legislative assembly amended the North Dakota corporate farming statute in 1933<sup>36</sup> and 1935.<sup>37</sup> The legislature unsuccessfully attempted to amend the corporate farming statute several other times.<sup>38</sup> Proponents of the movement to allow corporate farming in North Dakota finally prevailed in 1981 with the present bill, which allows certain corporations to engage in farming or ranching if the corporation meets the statutory requirements.<sup>39</sup>

### III. NORTH DAKOTA'S NEW CORPORATE FARMING STATUTE

In 1981 North Dakota ended the prohibition of corporate farming and ranching.<sup>40</sup> North Dakota's corporate farming statute is found in chapter 10-06 of the North Dakota Century Code.<sup>41</sup> The stated purpose of the act is as follows:

[T]o create and enact sections . . . of the North Dakota Century Code, defining farming or ranching, authorizing certain family-type corporations to engage in farming and ranching, and providing for reports and enforcement; to amend and reenact sections . . . of the North Dakota Century Code, prohibiting farming by corporations with

---

35. See Letter from Jay E. Buringrud to the Honorable Sherrod Brown (January 17, 1980) (included in the legislative history materials of Senate Bill 2233).

36. 1933 N.D. Sess. Laws ch. 89. The 1933 Legislature omitted the prohibition of corporations from acquiring or holding title to rural real estate in North Dakota. *Id.* § 1. It also made the ten year disposition period "a covenant, running with the title to the land against any grantee, successor or assignee of such corporation, which is also a corporation." *Id.* §§ 2 & 3. Finally, the legislature legalized title and ownership of any real estate acquired by a corporation since the initiated measure became effective, subject, however, to the provisions of the statute as amended. *Id.* § 4.

37. 1935 N.D. Sess. Laws ch. 111. The 1935 amendment more clearly enumerated the processes by which corporations could take or acquire title to real estate. *Id.*

38. Although the corporate farming statute of 1933 was often discussed by the legislature, it was not until 1967 that the assembly passed a bill which would have allowed corporate farming. 1967 N.D. Sess. Laws ch. 97. The 1967 bill would have allowed corporations to own real estate and operate farms and ranches if the corporation had no more than ten shareholders, only one class of stock, and income from rent, royalties, dividends, interest, and annuities composing less than 20% of the corporation's gross receipts. *Id.* This bill was vetoed by the governor, but the veto was overridden by the house of representatives and the senate. *Id.* The bill, however, was referred to the people and disapproved on November 5, 1968 by a vote of 171,321 to 53,938. 1969 N.D. Sess. Laws ch. 580.

In 1974 an initiated measure was placed on the ballot which would have allowed limited corporate farming where there were no more than ten shareholders, the stockholders were all members of the same family, at least one family member was actively engaged in farming, and no stockholder was a corporation. 1975 N.D. Sess. Laws ch. 601. This initiated measure was defeated by a vote of 130,026 to 73,874. *Id.*

Again, in 1979, a bill very similar to the family farming statute of 1981 was passed by the legislative assembly; it was vetoed, however, by Governor Arthur Link on March 28, 1979. 1979 N.D. Sess. Laws ch. 679.

39. 1981 N.D. Sess. Laws ch. 134.

40. *Id.*

41. N.D. CENT. CODE §§ 10-06-01 to -15 (Supp. 1981).

an exception for certain cooperatives; to repeal sections . . . of the North Dakota Century Code, relating to disposal of lands acquired by corporations in violation of the law; and to provide a penalty.<sup>42</sup>

The new statute permits farm incorporation as long as the members or shareholders are related within the kinship degree prescribed by the statute.<sup>43</sup> There is also a limit on the number of shareholders in the corporation.<sup>44</sup> The statute requires the officers and directors of the corporation to be actively engaged in operating the farm or ranch.<sup>45</sup> There are limits on the extent of outside income that may be earned by the corporation.<sup>46</sup> The corporation must also keep records which will facilitate enforcement of the statute.<sup>47</sup>

The following will be an attempt to familiarize the reader with what the legislature has done by allowing family farms to incorporate. The North Dakota Legislature has adopted many provisions similar to those found in other midwestern states permitting corporate farming.<sup>48</sup> The legislative history of the bill is also an important source in determining what the legislature intended. By using these two sources, what the legislature has permitted by the passage of the corporate farming statute should become clear.

#### A. WHO MAY INCORPORATE

Basic to an analysis of farm incorporation is a discussion of who may use the corporate form. The new act continues the prohibition against incorporation by those not specifically mentioned in the statute.<sup>49</sup> The group permitted to incorporate, however, has been expanded to include certain family farms<sup>50</sup> in addition to the cooperative corporations previously allowed.<sup>51</sup> Also,

42. 1981 N.D. Sess. Laws ch. 134.

43. N.D. CENT. CODE § 10-06-07(2) (Supp. 1981).

44. *Id.* § 10-06-07(1).

45. *Id.* § 10-06-07(5).

46. *Id.* § 10-06-07(6), (7).

47. *Id.* § 10-06-08.

48. *See, e.g.*, IOWA CODE ANN. §§ 172C.1-.15 (West Supp. 1981-1982); KAN. STAT. ANN. §§ 17-5901 to -5902 (1974); MINN. STAT. ANN. § 500.24 (West Supp. 1982); MO. ANN. STAT. §§ 350.010-.030 (Vernon Supp. 1982); NEB. REV. STAT. §§ 76-1501 to -1506 (Supp. 1976); OKLA. STAT. ANN. tit. 18, §§ 951-956 (West Supp. 1981-1982); S.D. CODIFIED LAWS ANN. §§ 47-9A-1 to -23 (Supp. 1981); WIS. STAT. ANN. § 182.001 (West Supp. 1981-1982). For an article comparing the different provisions of the midwestern states' statutes see Phelps, *Corporate Farming Statutes*, 2 WHITTIER L. REV. 441 (1980).

49. N.D. CENT. CODE § 10-06-01 (Supp. 1981).

50. *Id.* § 10-06-07.

51. *Id.* § 10-06-04.

certain creditor corporations will be allowed to acquire title to farm and ranch land;<sup>52</sup> however, they are not allowed to engage in farming or ranching<sup>53</sup> and must dispose of the land within three years.<sup>54</sup>

Before analyzing who is permitted to incorporate for the purpose of farming and ranching, it must be determined what is meant by the terms farming and ranching. The legislature has implemented a broad definition of farming and ranching which covers all traditional agricultural activities.<sup>55</sup> These traditional activities include the production of agricultural crops, livestock, poultry, dairy, fruit, and horticultural products.<sup>56</sup> The statute excludes forestry, the processing or distributing of farm products, and the supplying of farm services.<sup>57</sup> Most other midwestern states that permit corporate farming have a similar broad definition of farming and ranching, but they often provide more exceptions.<sup>58</sup> These exceptions allow incorporation for the purposes of research,<sup>59</sup> raising breeding stock,<sup>60</sup> or livestock feeding.<sup>61</sup> The absence of exceptions to the North Dakota definition may be explained by the fact that the legislature intended to establish a narrow bill to ensure its passage.<sup>62</sup>

After defining farming and ranching, an in-depth examination of who may incorporate is necessary. All corporations are prohibited from owning or leasing farm or ranch land or from

52. *Id.* § 10-06-13.

53. *Id.*

54. *Id.*

55. *Id.* § 10-06-01(1). The statute provides the following:

As used in this chapter, "farming or ranching" means 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 a processor or distributor of farm products or supplies provides grain, harvesting, or other farm services.

*Id.*

56. *Id.*

57. *Id.*

58. IOWA CODE ANN. § 172C.1(6) (West Supp. 1981-1982) (similar definition with exclusions for production of nursery products and sod); MINN. STAT. ANN. § 500.24 subd. 2, subd.3(g) (West Supp. 1982) (similar definition with exclusions for production of poultry and poultry products, land operated for research or experimental purposes, raising breeding stock for sale to farmers, and growing seed, wild rice, nursery plants or sod); S.D. CODIFIED LAWS ANN. § 47-9A-2(2) (Supp. 1981) (similar definition with exclusions for farms operated for research or experimental purposes, raising breeding stock for resale to farmers, growing seed, nursery plants or sod, and feeding livestock); WIS. STAT. ANN. § 182.001(3) (West Supp. 1981-1982) (more specific definition with exclusions for research, breeding operations, and the production of crops for seed).

59. *See, e.g.*, IOWA CODE ANN. § 172C.4(2) (West Supp. 1981-1982).

60. *See, e.g.*, MINN. STAT. ANN. § 500.24 subd. 3(e) (West Supp. 1982).

61. *See, e.g.*, S.D. CODIFIED LAWS ANN. § 47-9A-11 (Supp. 1981).

62. *Senate Agricultural Hearings*, *supra* note 3 (comments of Sen. Iszler, cosponsor of the bill). Mr. Iszler indicated that the legislature should draft a bill that would pass, and any changes needed in the legislation could be made in future legislative sessions. *Id.*



engaging in the business of farming or ranching unless permitted by the statute.<sup>63</sup> The definition of corporation includes any joint stock company or association.<sup>64</sup> The statutes of other midwestern states also contain a similar broad prohibition before listing who may incorporate.<sup>65</sup>

In North Dakota three types of corporations are permitted to own or lease farm or ranch land or to engage in the business of farming or ranching. These are cooperative corporations,<sup>66</sup> creditor corporations,<sup>67</sup> and family farm corporations.<sup>68</sup> Unlike the statutes of other midwestern states,<sup>69</sup> the North Dakota corporate farming statute does not permit nonprofit corporations, such as charities, to own or lease farm or ranch land or to engage in farming or ranching.<sup>70</sup> The corporate farming statute lists specific requirements that must be met by corporate farms before they will be permitted to own rural real estate or engage in agricultural activities.

With regard to the cooperative corporation the North Dakota statute states the following: "This chapter does not prohibit cooperative corporations, seventy-five percent of whose members or shareholders are actual farmers or ranchers residing on farms or ranches or depending principally on farming or ranching for their livelihood, from acquiring real estate and engaging in cooperative farming or ranching."<sup>71</sup> This section perpetuates the cooperative exception provided in the previous corporate farming statute.<sup>72</sup> The people of North Dakota traditionally have respected

---

63. N.D. CENT. CODE § 10-06-01 (Supp. 1981). The statute provides as follows: "All corporations, except as otherwise provided in this chapter, are prohibited from owning or leasing land used for farming or ranching and from engaging in the business of farming or ranching. As used in this chapter, 'corporation' includes any joint stock company or association." *Id.*

64. *Id.* Joint stock companies are similar to corporations in that each has transferable shares, is centrally managed, and is created by capital pooling. See J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP 178-79 (1977). Joint stock companies, however, do not possess limited shareholder liability as corporations do. *Id.* at 179-80. Corporate shareholders have their liability limited to the amount they invest in the corporation, while members of joint stock companies are generally jointly and severally liable for the entire amount of the joint stock company's debt. *Id.*

Association refers to "[the] act of a number of persons in uniting together for some special purpose or business." BLACK'S LAW DICTIONARY 111 (5th ed. 1979). For the purpose of the corporate farming statute, association probably refers to any business organization similar to the corporate form.

65. See, e.g., IOWA CODE ANN. § 172C.4 (West Supp. 1981-1982).

66. N.D. CENT. CODE § 10-06-04 (Supp. 1981).

67. *Id.* § 10-06-13.

68. *Id.* § 10-06-07.

69. See, e.g., MINN. STAT. ANN. § 500.24 subd. 3 (g) (West Supp. 1982).

70. N.D. CENT. CODE §§ 10-06-01, -07 (Supp. 1981).

71. *Id.* § 10-06-04.

72. 1933 N.D. Sess. Laws 494. There has been little change from the original section which provided "[t]hat nothing in this act shall be construed to prohibit cooperative corporations, seventy-five per cent of whose members or stockholders are actual farmers, residing in (on) farms or depending principally on farming for their livelihood, from acquiring real estate and engaging in cooperative farming or agriculture." *Id.*

cooperatives and perceive them as opponents of big business.<sup>73</sup> The requirements inherent in the cooperative form generally render it impractical for use by the types of corporations the statute continues to prohibit.<sup>74</sup> The legislature reflected the perceptions of the people in retaining the exception for cooperative corporations.<sup>75</sup>

The exception permitting creditor corporations to acquire title to rural real estate<sup>76</sup> is similar to the previous corporate farming statute;<sup>77</sup> however, the restrictions on the length of ownership and the use of the land have been narrowed. Creditor corporations may obtain title to farm or ranch land only as security for indebtedness,<sup>78</sup> "by process of law in the collection of debts, or by any procedure for the enforcement of a lien or claim thereon, whether created by mortgage or otherwise."<sup>79</sup> If the corporation does not otherwise qualify under this statute, the land must be disposed of within three years of acquisition.<sup>80</sup> If disposition is required, the land shall be leased in the interim to persons actually engaged in farming or ranching.<sup>81</sup> Additionally, disposal shall not be to a corporation unless such corporation qualifies under the provisions of the corporate farming statute.<sup>82</sup>

73. The cooperatives were formed to protect North Dakota farmers from outside business interests that were depressing farm prices. See E. ROBINSON, *HISTORY OF NORTH DAKOTA* 383 (1966).

74. Cooperatives are generally made up of large numbers of farmers or ranchers; therefore, the agricultural interests of the majority of members prevail. This prevents exploitation of small farmers because the majority of the members are generally small farmers.

75. Professor William Phelps, visiting professor at the University of North Dakota School of Law during Fall Semester, 1981 and author of *Corporate Farming Statutes*, 2 WHITTIER L. REV. 441 (1980) stated that a group of farmers and ranchers with extensive tracts of land could conceivably create a "super-cooperative" that would have interests adverse to most small farmers and ranchers in North Dakota. Interview with William Phelps, Associate Professor of Law, Whittier College of Law (Oct. 29, 1981). North Dakota will have to take the chance of this happening in order to retain the cooperative corporate form.

76. N.D. CENT. CODE § 10-06-13 (Supp. 1981). The relevant portions of this section state the following:

Any domestic or foreign corporation may acquire farm or ranch land as security for indebtedness, by process of law in the collection debts, or by any procedure for the enforcement of a lien or a claim thereon, whether created by mortgage or otherwise. All farm or ranch land acquired as security for indebtedness, in the collection of debts, or by the enforcement of a lien or claim shall be disposed of within three years after acquiring ownership, if the acquisition would otherwise violate the chapter. In the interim such land shall be leased to persons actually engaged in farming or ranching and a disposal shall not be to a corporation other than a corporation authorized under the provisions of this chapter.

*Id.*

77. 1933 N.D. Sess. Laws 494, § 3.

78. N.D. CENT. CODE § 10-06-13 (Supp. 1981). The enforcement provision of the Act states that "[a]ny domestic or foreign corporation may acquire farm or ranch land as security for indebtedness . . . ." *Id.*

79. *Id.*

80. *Id.* The statute provides in pertinent part that "[a]ll farm or ranch land acquired as security for indebtedness, in the collection of debts, or by the enforcement of a lien or claim shall be disposed of within three years after acquiring ownership, if the acquisition would otherwise violate this chapter." *Id.*

81. *Id.*

82. *Id.*

Under the 1932 corporate farming statute a creditor corporation could hold title to the land for ten years.<sup>83</sup> The 1932 statute also allowed the creditor corporations to farm the land in the interim period before disposal.<sup>84</sup> The practical effect of the 1981 restrictions on creditor corporations is to protect their legitimate business interests while preventing the accumulation of farm or ranch land by such corporations.<sup>85</sup> Also, farmers and ranchers will still be able to obtain the necessary credit to keep their operations viable.<sup>86</sup>

Although cooperative corporations and creditor corporations are discussed in the 1981 corporate farming statute, family farm corporations are the corporations receiving the major emphasis. The statute permits incorporation of the family farm if the resulting corporation meets the statute's numerical<sup>87</sup> and familial requirements.<sup>88</sup> There are also restrictions as to who can be a shareholder or member of the corporation.<sup>89</sup> Additionally, there are demands as to the involvement in the farm or ranch operation required of the officers and directors.<sup>90</sup> Finally, there are limits on the amount of outside income that may be generated by the corporation.<sup>91</sup> Unless the farm corporation complies with all these requirements, the state will not issue a certificate of incorporation.<sup>92</sup>

The numerical requirement for farm incorporation provides that "[t]he corporation does not have more than fifteen shareholders or members."<sup>93</sup> It is arguable that the limit on the number of shareholders or members is not random because it is identical to the maximum number of shareholders permitted at the time the corporate farming statute was passed to form a Subchapter

83. 1933 N.D. Sess. Laws 494, § 3.

84. *Id.*

85. The creditor corporations will be protected when making loans to farmers and ranchers because if the farmers and ranchers cannot repay these loans, the lending institution has statutory power to acquire these lands as security for indebtedness. N.D. CENT. CODE § 10-06-13 (Supp. 1981). The lending institution, however, must dispose of the land within three years. *Id.*

86. It is common knowledge that farmers often rely on credit, especially when expanding the size of the farm or ranch. New farmers and ranchers need large amounts of capital to commence operations. A provision, therefore, for the benefit of creditor corporations also helps the farmers and ranchers of North Dakota.

87. N.D. CENT. CODE § 10-06-07(1) (Supp. 1981) (15 shareholders or members).

88. *Id.* § 10-06-07(2) (shareholders or members must be related to other shareholders or members within specified degrees of kinship).

89. *Id.* § 10-06-07(3), (4) (shareholder must be an individual United States citizen or permanent resident alien of the United States; exception for some trusts and estates).

90. *Id.* § 10-06-07(5) (officers and directors must be shareholders or members actively engaged in operating farm).

91. *Id.* § 10-06-07(6), (7) (65% of corporation's annual average gross income must be derived from farming or ranching; income from rent, royalties, dividends, interest, and annuities must not exceed 20% of corporation's gross receipts).

92. *Id.* §§ 10-06-01, -07, -08.

93. *Id.* § 10-06-07(1).

S corporation.<sup>94</sup> It should be noted, however, that the Economic Recovery Tax Act of 1981 increased the maximum number of shareholders in a Subchapter S corporation to twenty-five.<sup>95</sup> A Subchapter S corporation receives the economic benefit of tax treatment as a partnership if it meets statutory requirements.<sup>96</sup> Only the individual shareholders of a Subchapter S corporation are taxed on the income earned by the corporation; the corporation itself is not taxed.<sup>97</sup>

Even though derived from the Subchapter S restriction,<sup>98</sup> it may be argued that the North Dakota statutory limit of fifteen shareholders is too restrictive. Even small families may easily reach this numerical limit. For example, three married siblings with three children per family are at the numerical limit if all family members are to be included in the corporation. Any maximum number of shareholders, however, would be open to criticism; therefore, the limit of fifteen appears acceptable at the present time.<sup>99</sup>

In addition to the numerical limit of fifteen members, there is a limit on the degree to which the members or shareholders must be related in order to incorporate. The statute demands that "[e]ach shareholder or member is related to each of the other shareholders or members within one of the following degrees of kinship: parent, child, grandparent, grandchild, brother, sister, uncle, aunt, nephew, niece, great-grandparent, great-grandchild, first cousin, or is the spouse of a person so related."<sup>100</sup> The statute states explicitly who can be a shareholder or member rather than stating general degrees of kinship, which may be confusing and too restrictive.<sup>101</sup>

94. I.R.C. § 1371(a)(1) (West Supp. 1981). The other general requirements of a Subchapter S corporation are that it can only have one class of stock and the shareholders must be individual persons. *Id.* § 1371(a)(2), (4) (West Supp. 1981). This is not provided for in the North Dakota corporate farming act. N.D. CENT. CODE § 10-06-07 (Supp. 1981).

95. I.R.C. § 1371(a)(1) (West Supp. 3, 1981).

96. *Id.* § 1372 (b) (West Supp. 1981).

97. *Id.* § 1373(a) (West 1967). Section 1373(a) states that "[t]he undistributed taxable income of an electing small business corporation for any taxable year shall be included in the gross income of the shareholders of such corporation in the manner and to the extent set forth in this section." *Id.*

98. *Id.* § 1371(a)(1) (West Supp. 1981), as amended by § 1371(a)(1) (West Supp. 3, 1981).

99. The reasonableness of the 15 member or shareholder limit is supported by an interesting bit of information. In 1978, 131 farms in North Dakota were organized as corporations. 2 U.S. DEP'T OF COMMERCE, 1978 CENSUS OF AGRICULTURE part 34, at 1 (1981). This is extraordinary in light of the fact that corporations have been prohibited from engaging in farm operations in North Dakota for almost 50 years. 1933 N.D. Sess. Laws 494, § 1. Of these 131 corporations, which do not include cooperative corporations, estates, or trusts, only six contain more than ten shareholders. 1 U.S. DEP'T OF COMMERCE, 1978 CENSUS OF AGRICULTURE part 34, at 31 (1981).

100. N.D. CENT. CODE § 10-06-07(2) (Supp. 1981).

101. *See, e.g.,* S.D. CODIFIED LAWS ANN. § 47-9A-14 (Supp. 1981). South Dakota limits the kinship requirement to the third degree which may be difficult for laymen to understand. Additionally, the third degree of kinship does not include cousins, making South Dakota's law more restrictive than North Dakota's. For an article discussing South Dakota's corporate farming act, see

It should be noted that the kinship requirements established by the North Dakota Legislature also may be too restrictive.<sup>102</sup> A family farm corporation continuing as an ongoing entity for a number of generations may exceed the kinship limit. For example, a father may incorporate and allow his children to become members or shareholders of the corporation. These sons and daughters may permit their children to become shareholders or members of the corporation; however, the next generation will not be related to each other within the degrees of kinship enumerated in the statute. Therefore, the statute may require farm corporations to restrict family participation every third generation. The legislative intent to draft a narrow statute to ensure passage of the corporate farming act may have created a familial limit that will need changing in the future if it is found to be too restrictive for practical application.<sup>103</sup>

Even though the North Dakota corporate farming act limits the permissible number of members or shareholders to fifteen, the act permits entities other than natural persons to be members or shareholders. The statute defines shareholder as follows:

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 or member of the corporation within the degrees of kinship specified in this section.
- b. An estate of a decedent who was related to a shareholder or member 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 and members are more than fifteen in number.<sup>104</sup>

With regard to the familial relationships between the beneficiaries of the trusts and estates and the other members or

---

Comment, *The South Dakota Family Farm Act of 1974: Salvation or Frustration for the Family Farmer?*, 20 S.D.L. REV. 575 (1975) [hereinafter cited as Comment, *The South Dakota Act*].

102. It may be that the legislature intended a narrow passable bill rather than a workable bill. See *Senate Agricultural Hearings*, *supra* note 3 (comments of Sen. Iszler).

103. Statements contained in the legislative history indicate that a restrictive bill was intended because it is easier to loosen a strict bill than to tighten up a broad bill. *Senate Agricultural Hearings*, *supra* note 3 (February 12, 1981) (comments of Sen. Dotzenrod).

104. N.D. CENT. CODE § 10-06-07(3) (Supp. 1981).

shareholders of the corporation, the statute appears to be inconsistent. The act retains the numerical limit of fifteen members or shareholders in the corporation, including the beneficiaries of trusts and estates, but requires the beneficiaries of a trust or an estate of a decedent to be related only to "a" shareholder or member of the corporation rather than "each" shareholder or member.<sup>105</sup> It is unclear whether this was the intent of the legislature or whether it was a grammatical error, drafting error, or an oversight; however, it seems inconsistent to retain the numerical limit but not the kinship requirement with regards to beneficiaries of trusts and estates.<sup>106</sup>

The corporate farming statute further requires that "[e]ach individual who is a shareholder or member . . . [must be] a citizen of the United States or a permanent resident alien of the United States."<sup>107</sup> This requirement is included to further the intent of preventing absentee ownership.<sup>108</sup> Several other midwestern states adopted corporate farming and anti-alien farm holding statutes simultaneously;<sup>109</sup> it is therefore possible that North Dakota adopted the anti-alien farm holding provision to limit foreign ownership consistent with other states.

In addition to preventing absentee ownership, the North Dakota statute mandates that "[t]he officers and directors of the corporation must be shareholders or members who are actively engaged in operating the farm or ranch and at least one of its shareholders or members shall be an individual residing on or operating the farm or ranch."<sup>110</sup> While this is a very important requirement, the statute and its legislative history are unclear as to the specific intent of the legislature. The North Dakota Legislature has not indicated what is meant by the phrases "actively engaged in

---

105. *Id.* The class of persons benefitting from a corporate farm or ranch may be extended if the beneficiaries of the trust or estate need not be related to each shareholder. The Farmers Union, which historically has opposed corporate farming in North Dakota, proposed this section of the corporate farming bill. *Senate Agricultural Hearings*, *supra* note 3 (comments of Allan Austad, North Dakota Farmers Union). When explaining this provision the legislative history indicates that the beneficiaries must be related members; however, it does not clarify whether the beneficiaries of trusts and estates must be related to each shareholder within the statutory requirements. *Id.* (February 6, 1981) (comments of Mr. Austad).

106. Although not indicated anywhere in the legislative history, the legislature may have intended that the beneficiaries of the shareholder trusts and member estates need only be related to one other shareholder. This would lessen the severity of the kinship requirement. The numerical limit of 15 is retained as to the beneficiaries of trusts and estates which should prevent abuse of the corporate farming act. N.D. CENT. CODE § 10-06-07(3) (Supp. 1981).

107. *Id.* § 10-06-07(4).

108. The family farm is preserved by a narrow statute which prevents large corporations from engaging in farming in North Dakota. *House Agricultural Hearings*, *supra* note 5 (March 13, 1981) (statement of Att'y Gen. Robert Wefald).

109. *See, e.g.*, MINN. STAT. ANN. § 500.221 Subd. 2 (West Supp. 1982). The theory is the same with regard to aliens as it is to out of state interests; North Dakota protects its citizens by putting restrictions on foreign interests.

110. N.D. CENT. CODE § 10-06-07(5) (Supp. 1981).

operating the farm or ranch” and “residing on or operating the farm or ranch.”<sup>111</sup> The legislative history provides no guidance as to these definitions; therefore, this part of the statute will have to be interpreted by future legislative amendments and judicial decisions.

The opaqueness of the statute leaves it open to possible challenges and attempted avoidance. The legislature may have intended to draft a narrow corporate farming bill, but it appears they may not have succeeded in this area. For example, the statute directs that a shareholder or member must reside on or operate the farm or ranch, yet one need not reside on the farm or ranch to operate the farm or ranch. The farmer or rancher may reside anywhere.<sup>112</sup> If “operating the farm or ranch” is broadly defined in the future, North Dakota farms and ranches may be operated by persons who are not North Dakota residents.

The legislature was encouraged to be clearer as to what was intended by the officer and director participation section of the corporate farming statute.<sup>113</sup> The failure to act opens this section to many possible challenges. For example, the statute leaves the following questions unanswered: What must a housewife do to actively engage in operating the farm or ranch? Does an officer or director have to operate the machinery to be actively engaged in operating the farm or ranch? Can an officer or director operate a ranch strictly from a management position? Repeatedly, the intent of the narrow statute may be challenged due to the vagueness of this section.

The last requirement as to who may incorporate for the

---

111. *Id.* Of course it is impossible to absolutely define what is meant by these two phrases. It would be helpful, however, if the legislature had given some indication of what is meant by “actually engaged in operating the farm or ranch” or “residing on or operating the farm or ranch.” One state statute provides the following:

“Actively engaged in farming” means that a natural person who is a shareholder and an officer, director or employee of the corporation either:

- a. Inspects the production activities periodically and furnishes at least half of the value of the tools and pays at least half the direct cost of production; or
- b. Regularly and frequently makes or takes an important part in making management decisions substantially contributing to or affecting the success of the farm operation; or
- c. Performs physical work which significantly contributes to crop or livestock production.

IOWA CODE ANN. § 172C.1 (15) (West Supp. 1981-1982).

112. North Dakota’s provision as to one shareholder residing on or operating the farm is similar to the South Dakota statute. S.D. CODIFIED LAWS ANN. § 47-9A-14 (Supp. 1981). A technical reading of this provision does not require a shareholder to reside on the farm. *Contra*, Comment, *The South Dakota Act*, *supra* note 101, at 586-87 (section 47-9A-14 requires one of the stockholders to reside on the farm).

113. See *House Agricultural Hearings*, *supra* note 5 (March 13, 1981) (prepared testimony presented by Jeff Smedsrud on behalf of Communicating for Agriculture).

purpose of engaging in the business of farming or ranching limits the amount of outside income that may be earned by the family farm corporation. The statute places two restrictions on outside income. First, “[a]n annual average of at least sixty-five 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.”<sup>114</sup> Second, “[t]he corporation’s income from rent, royalties, dividends, interest, and annuities . . . [must] not exceed twenty percent of the corporation’s gross receipts.”<sup>115</sup> These standards allow the family farm corporation to receive a limited amount of income from sources other than farming or ranching.<sup>116</sup>

To prevent violations of this section of the corporate farming act, care is required when forming the corporation. There are a number of ways a farmer or rancher can avoid violating the outside income provisions of the statute. One would be to form two corporations, with one receiving income from farming and ranching operations and the other receiving gross income from outside sources. Another possible method of compliance with these statutory provisions would be to exclude the farm or ranch land from the corporate assets. This would ensure that any income generated from the land would not be gross income attributable to the corporation. Any farmer or rancher who will be incorporating should plan carefully, so that all the statutory requirements governing who may incorporate are satisfied.<sup>117</sup>

## B. RECORDS AND REPORTS

Once incorporated, all family farm corporations will be required to keep records concerning the corporation<sup>118</sup> and to file reports with the state regarding the corporation.<sup>119</sup> Extensive record keeping and reporting should prove beneficial to the farmers and ranchers who incorporate. These records and reports will be useful when making management decisions. The state also has an interest in requiring the farmer or rancher to maintain accurate records and to file timely reports. Corporate records and reports will enable the state to detect violations of the corporate farming

---

114. N.D. CENT. CODE § 10-06-07(6) (Supp. 1981).

115. *Id.* § 10-06-07(7).

116. The legislative history reflects statements that caution should be used when incorporating to ensure that the corporation’s outside income is not too great. *House Agricultural Hearings, supra* note 5 (March 16, 1981) (testimony of James Marsden on behalf of the North Dakota Farm Bureau).

117. N.D. CENT. CODE §§ 10-06-01 to -15 (Supp. 1981).

118. § 10-06-08 (corporation required to keep records of stock transfers).

119. *Id.* (reports must be filed with the articles of incorporation and, thereafter, annually).



statute and will assist in the enforcement provisions of the statute.<sup>120</sup>

There are different kinds of records and reports that must be kept and filed. At the time the articles of incorporation are filed, the corporation must file a report with the secretary of state.<sup>121</sup> Only after the secretary of state has approved the report will the corporation be allowed to commence farming or ranching operations.<sup>122</sup> The corporation must, thereafter, annually file with the secretary of state a report similar to the initial report necessary for commencing operations.<sup>123</sup> The secretary of state shall publish in the local newspaper certain information contained in these annual reports.<sup>124</sup> Finally, the corporation must keep a record of all transfers of shares and interests in the corporation.<sup>125</sup>

The information required in the report that must be approved by the secretary of state before farming or ranching operations may be commenced is quite extensive. The report must contain the name of the corporation with its place of incorporation, its

120. *Id.* §§ 10-06-10, -11.

121. *Id.* § 10-06-08. The relevant portions of the statute provide the following:

Every corporation engaged in farming or ranching after June 30, 1981, shall file with the secretary of state a report at the time of filing of the corporation's articles of incorporation and, thereafter, annually, prior to April fifteenth of each year containing all of the following information with respect to the preceding calendar year:

1. The name of the corporation and its place of incorporation.
2. The address of the registered office of the corporation in this state and the name and address of its registered agent in this state.
3. The acreage [hectarage] and location listed by section, township, range, and county of all land in the state owned or leased by the corporation and used for farming or ranching.
4. The names and addresses of the officers and the members of the board of directors of the corporation.
5. The number of shares of stock or the percentage of interest in the acreage [hectarage] the corporation used for farming or ranching owned or leased by persons residing on the farm or ranch and actively engaged in farming or ranching and the number of shares of stock or the percentage of interest in the acreage [hectarage] the corporation used for farming or ranching owned or leased by relatives within the degree of kinship listed in subsection 2 of section 10-06-07.
6. The name, address, and number of shares of stock or the percentage of interest in the acreage [hectarage] the corporation used for farming or ranching owned or leased by each shareholder or member and the relationship of each shareholder or member to the other shareholders or members. The names and addresses and relationships of beneficiaries of trusts and estates must also be included in the report.
7. A statement as to the percentage of gross receipts of the corporation derived from rent, royalties, dividends, interest and annuities. In addition, the corporation shall report the same information specified above as to any other shareholder or member since the last previous report.

*Id.*

122. *Id.* The statute provides that "[n]o corporation may commence farming or ranching in this state until the secretary of state has inspected the initial report and certified that the corporation's proposed operations comply with section 10-06-07." *Id.*

123. *Id.* The annual report is to be filed "prior to April fifteenth of each year. . . ." *Id.*

124. *Id.*

125. *Id.*

registered office and the name and address of its registered agent, the location of all land owned and leased by the corporation used for farming and ranching, and the names and addresses of the officers and the board of directors of the corporation.<sup>126</sup> Additionally, the report must include the interests of those residing on or operating the farm or ranch and of those relatives involved in the corporation, and the names, addresses, and interests of each member or shareholder.<sup>127</sup> Finally, there shall be a statement as to the gross receipts of the corporation.<sup>128</sup>

All the information required in the corporation's annual reports should be readily available to the farmer or rancher who has carefully planned the incorporation. Most other midwestern states require similar reports to be filed by their family farm corporations.<sup>129</sup> Although the information contained in these reports appears extensive, the information generally will remain the same year after year. It should be noted that some information contained in the annual report will become public.<sup>130</sup> The filing of reports, however, should not be considered a deterrent to incorporation unless the farmer wishes his or her personal and business affairs to be kept private.

The initial report is to be filed with the articles of incorporation and approved by the secretary of state.<sup>131</sup> The North Dakota law provides the following: "No corporation may commence farming or ranching in this state until the secretary of state has inspected the initial report and certified that the corporation's proposed operations comply with section 10-06-07."<sup>132</sup> This provision places much of the responsibility for enforcing the statute on the secretary of state.<sup>133</sup> The secretary of state is to monitor all initial and annual reports.<sup>134</sup>

126. *Id.* § 10-06-08(1) to -08(4).

127. *Id.* § 10-06-08(5), (6).

128. *Id.* § 10-06-08(7).

129. *See, e.g.*, S.D. CODIFIED LAWS ANN. §§ 47-9A-16, -17 (Supp. 1981).

130. N.D. CENT. CODE § 10-06-08 (Supp. 1981). After the annual report is filed, the secretary of state will have printed in a newspaper in each county where the corporation owns land the name of the corporation, a list of the shareholders or members and a statement that the corporation owns or leases land for farming or ranching. *Id.* Additionally, a description of the land is to be available for public inspection at the secretary of state's office. *Id.*

131. *Id.*

132. *Id.*

133. *Id.* It is up to the secretary of state to ensure that only qualified corporations will begin farming and ranching operations in North Dakota. *Id.*

134. *Id.* In some states, however, the secretary of agriculture reviews the reports filed by farm corporations. MINN. STAT. ANN. § 500.24(4) (West Supp. 1982); OKLA. STAT. ANN. tit. 18, § 951(A)(4) (West Supp. 1981-1982).

North Dakota's secretary of state can only detect violations committed by corporations that file reports. Undetected violations of the 1933 anticorporate farming statute have apparently occurred. The legislative history of the corporate farming act mentions that the 1969 Census of Agriculture reported over 100 farm corporations in North Dakota; only a small percentage of these had been

In addition to receiving annual reports, the secretary of state shall publish certain information contained in those reports.<sup>135</sup> The required information is to be published in a newspaper of general circulation in each county in which the corporation owns or leases land.<sup>136</sup> The information to be published shall state the name of the corporation and its shareholders or members, that the corporation has filed its annual report, and that a description of the land owned or leased by the corporation in that county is available for inspection.<sup>137</sup> The reason for this publication is to put private citizens on notice of area family farm corporations.<sup>138</sup> The corporate farming act contains a private enforcement provision.<sup>139</sup> Such information will be essential if there is to be effective private enforcement.<sup>140</sup>

Lastly, a corporation must keep a record of each transfer of shares or interests in the corporation.<sup>141</sup> The secretary of the corporation is to record the names of the transferor and transferee, their relationship, the number of shares or percentage of interests transferred, and the date of the transfer.<sup>142</sup> The statute does not require the stock transfer records to be filed;<sup>143</sup> however, they must

---

authorized by the secretary of state. *Senate Agricultural Hearings, supra* note 3 (testimony of Allan Austad on behalf of the North Dakota Farmers Union). The private enforcement provision of the 1981 corporate farming act should assist the attorney general, however, in preventing statutory noncompliance. N.D. CENT. CODE § 10-06-14 (Supp. 1981).

135. N.D. CENT. CODE § 10-06-08 (Supp. 1981). The statutory language provides as follows:

Upon receiving the annual reports required by this section, the secretary of state shall cause to be printed in a newspaper of general circulation in each county or counties wherein any land is owned or leased by each corporation filing a report the following: The names of each corporation and its respective shareholders or members as listed in the annual report and a statement to the effect that each of the corporations listed has filed in its annual report that it owns or leases land used for farming or ranching within the county and that a description of such lands is available for inspection at the secretary of state's office.

*Id.*

136. *Id.*

137. *Id.*

138. *Senate Agricultural Hearings, supra* note 3 (February 12, 1981) (explanation of proposed amendment No. 10).

139. N.D. CENT. CODE § 10-06-14 (Supp. 1981).

140. *See infra* notes 169-72 and accompanying text.

141. N.D. CENT. CODE § 10-06-08 (Supp. 1981). The statute requires the following:

Every corporation owning or leasing land used for farming or ranching or engaged in farming or ranching after June 30, 1981, shall keep a record of transfers of shares or transfers of interests in the corporation. The corporation's secretary shall therein cause to be recorded all transfers of shares or transfers of interests among and between the corporation and its respective shareholders or holders of interest. Such record shall contain at least the following: The names of the transferor and transferee, their relationship, the number of shares or the percentage of interests transferred and the date of the transfer.

*Id.*

142. *Id.*

143. *Id.* (no reference to a filing requirement).

be available for inspection at the request of the attorney general.<sup>144</sup> It is clear that these reports and records will aid the state in the enforcement of the corporate farming statute.<sup>145</sup>

The corporate farming statute provides a penalty if the reports are not filed or if the information contained in them is incorrect. The statute states that “[e]very corporation which fails to file any report required under this chapter or willfully files false information on any report required under this chapter is guilty of a class A misdemeanor.”<sup>146</sup> An organization committing a class A misdemeanor shall be subject to a maximum fine of fifteen thousand dollars.<sup>147</sup> Such a large fine should act as a deterrent to any deliberate avoidance of the statute. Unintentional inaccuracies will not be punished; only willfully filed false information or failure to file a required report are subject to the statute.<sup>148</sup> The records to be kept by the corporation and the reports it must file with the state are an integral component of the corporate farming statute in that they are the link between the incorporation and enforcement provisions of the statute. By making the necessary information readily available, the records and reports will facilitate detection of violations of the corporate farming act.

### C. ENFORCEMENT

The records and reports required of the corporation are valuable to the enforcement process. The reports provide information necessary for detecting noncompliance. The statutory provisions require state officials<sup>149</sup> and permit private citizens<sup>150</sup> to be involved in enforcement. The attorney general may pursue the action for the state<sup>151</sup> or private citizens may bring their own actions.<sup>152</sup>

---

144. *Id.* § 10-06-12.

145. The record keeping provision was included to facilitate follow-up enforcement by the state. *Senate Agricultural Hearings, supra* note 3 (comments of Allan Austad concerning amendments proposed by the Farmers Union).

146. N.D. CENT. CODE § 10-06-09 (Supp. 1981).

147. *Id.* § 12.1-32-01(4) (1976).

148. In a statement to the legislative assembly, Attorney General Robert Wefald said that the corporate farming act is to be a bill of compliance rather than a bill to penalize anyone engaged in family business; as a result strict enforcement will be discretionary. *House Agricultural Hearings, supra* note 5 (March 13, 1981) (statement of North Dakota Att’y Gen. Robert Wefald).

149. N.D. CENT. CODE §§ 10-06-10 to -12 (Supp. 1981). The state officials involved are the secretary of state, *id.* § 10-06-10, the state tax commissioner, *id.* § 10-06-11, the attorney general, *id.* § 10-06-12, and the governor. *Id.* §§ 10-06-10 to -11. The governor is involved in enforcement by the statutory provisions directing the secretary of state and the tax commissioner to notify both the governor and the attorney general of apparent violations of the corporate farming statute. *Id.*

150. *Id.* § 10-06-14.

151. *Id.* § 10-06-13.

152. *Id.* § 10-06-14.

### 1. *Detection of Noncompliance by State Officials*

Three state officials will monitor family farm corporations. The secretary of state, the state tax commissioner, and the attorney general all have the statutory duty to monitor farm corporations.<sup>153</sup> The secretary of state and the tax commissioner are to notify the attorney general and the governor of any noncompliance.<sup>154</sup> It is for the attorney general and the governor to decide whether legal action will be commenced.<sup>155</sup>

The secretary of state will attempt to detect any noncompliance using the annual reports that must be filed with his office by farm corporations.<sup>156</sup> The state tax commissioner will randomly select at least five percent of the corporate farm income tax returns to be compared with the annual reports filed with the secretary of state to discover any noncompliance.<sup>157</sup> In an attempt to uncover any noncompliance by family farm corporations, the attorney general is directed to select at least five percent of the total number of corporations each year and to request information from these corporations to determine noncompliance.<sup>158</sup> The attorney general is given broader powers than the secretary of state or the state tax commissioner in that he can request documents and records that the corporations are not required to file.<sup>159</sup> By having three different state officials monitor the corporate farms and ranches, North Dakota is increasing the chances of detecting

153. *Id.* §§ 10-06-10 to -12.

154. *Id.* §§ 10-06-10, -11.

155. *Id.* § 10-06-13; *Senate Agricultural Hearings, supra* note 3 (February 12, 1981) (explanation of proposed amendment No. 12). The legislative history states that the attorney general will further investigate apparent violations. *Id.*

156. N.D. CENT. CODE § 10-06-10 (Supp. 1981). The statute provides that, "[i]f the secretary of state shall find from the annual report that the corporation is not in compliance with the requirements of section 10-06-07, he shall transmit such information to the attorney general and the governor." *Id.*

157. *Id.* § 10-06-11. The statute provides as follows:

Each year the tax commissioner shall select at random at least five percent of the income tax returns filed by corporations which report on income from farming or ranching operations and shall compare such returns with the annual report required to be filed with the secretary of state by section 10-06-08 and shall forward any apparent violations to the attorney general and the governor.

*Id.*

158. *Id.* § 10-06-12. The statute provides as follows:

Each year the attorney general shall select at random at least five percent of the total number of corporations authorized by this chapter for requests for information to determine compliance with this chapter. For such purpose, the attorney general may request affidavits, stock transfer records, certified copies of marriage licenses, birth certificates, deeds, leases, and such other records and documents as shall be necessary to determine compliance.

*Id.*

159. *Id.*

noncompliance.<sup>160</sup> After detection of noncompliance, it is the attorney general's responsibility to judicially enforce the statute by bringing an action.<sup>161</sup>

## 2. *Judicial Enforcement*

If the state is to bring an action against a family farm corporation, the statute authorizes the attorney general to bring the action.<sup>162</sup> It seems likely that the attorney general will be able to exercise discretion as to whether to bring a legal action against a corporation.<sup>163</sup> Three possible legal remedies are available after a successful legal action against a family farm corporation. They are divestiture of the land owned or leased by the corporation in violation of the statute, combined with cessation of farming and ranching operations;<sup>164</sup> injunctive relief to enjoin prospective violations;<sup>165</sup> and dissolution of farm corporations by the attorney general and the secretary of state.<sup>166</sup>

The specifics of the enforcement provision begin by directing the attorney general to commence the action in the district court of the county in which the substantial portion of the land violating the statute is located.<sup>167</sup> The attorney general is also to file a notice of

160. Previously, there were no records or reports that could be checked by state officials to determine whether corporations were in compliance with the law. *Senate Agricultural Hearings, supra* note 3 (February 12, 1981) (explanation of proposed amendment No. 12).

161. N.D. CENT. CODE § 10-06-13 (Supp. 1981).

162. *Id.* The enforcement provision begins, "[t]he attorney general shall commence an action in the district court. . . ." *Id.*

163. *Id.* The statute directs the attorney general to commence an action when he "has reason to believe that any person is violating . . . [the corporate farming statute]." *Id.* Discretionary enforcement is especially likely in light of Attorney General Robert Wefald's statement to the legislature that the corporate farming statute is to be a bill of compliance rather than a law to penalize people for being engaged in a family business. *House Agricultural Hearings, supra* note 5 (March 13, 1981) (testimony of Att'y Gen. Robert Wefald).

164. N.D. CENT. CODE § 10-06-13 (Supp. 1981).

165. *Id.*

166. *Id.*

167. *Id.* The relevant portions of the judicial enforcement provision are as follows:

The attorney general shall commence an action in the district court of the county in which the substantial portion of farm or ranch land used in violation of this chapter is situated, if the attorney general has reason to believe that any person is violating this chapter. The attorney general shall file for record with the register of deeds of each county in which any portion of the land is located a notice of the pendency of the action. If the court finds that the land in question is being held in violation of this chapter, or that a corporation is conducting the business of farming or ranching in violation of this chapter, the court shall enter an order so declaring. The attorney general shall file any such order for record with the register of deeds of each county in which any portion of the land is located. Thereafter, the corporation shall, within the time set by the court not to exceed one year from the date of the court's final order, divest itself of any farming or ranching land owned or leased by it in violation of this chapter, and cease all farming and ranching operations. Any corporation that fails to comply with the court's order shall be dissolved by the secretary of state. The divestment period is deemed to be a covenant running with the title to the land against any corporate grantee, corporate successor, or corporation assignee of the

pendency of the action in any county in which a portion of the land is located.<sup>168</sup> These two steps occur after the attorney general has the information necessary to believe there is a violation of the corporate farming act.<sup>169</sup> The district court of the county in which a substantial portion of the disputed land is located is probably the most convenient forum for hearing the action. The persons living in that county are often the ones most likely to know the details of the corporate operations. Also, the notice of pendency of the action will protect prospective purchasers of disputed land. Prospective purchasers will be on notice that there is a legal dispute concerning the land, and will know to obtain the details of the dispute before purchasing the land.

After a successful legal action against a farm corporation, the statute authorizes three types of judicial relief — divestiture of the land and cessation of farming and ranching operations, injunctive relief, and dissolution of the corporation.<sup>170</sup> The particular situation will determine which remedy is to be used.

Divestiture of the land in question and cessation of farming and ranching operations by the corporation will be ordered by the district court when there is a violation of the corporate farming statute.<sup>171</sup> This order will be filed with the register of deeds of each county in which any of the corporation's agricultural land is located.<sup>172</sup> The corporation will then have one year from the date of the final order to divest itself of the land and cease all farming and ranching operations.<sup>173</sup> The divestment period will be conveyed with the title if assignment is to a corporation not authorized by the corporate farming statute.<sup>174</sup> Any land not divested within the one year period will be sold at a public sale.<sup>175</sup>

---

corporation not authorized to do business under this chapter. Any land not divested within the divestment period prescribed shall be sold at public sale in the manner prescribed by law for the foreclosure of real estate mortgage by action. In addition, any prospective or threatened violation may be enjoined by an action brought by the attorney general in the manner provided by law enjoining the corporation from completing performance of the remainder of any leasehold which is in violation of this chapter. . . . Any corporation continuing to violate the provisions of this chapter shall be dissolved by the attorney in accordance with the provisions of the laws of this state.

*Id.*

168. *Id.*

169. The information necessary to formulate a belief that a violation of the corporate farming statute requiring legal action by the state has occurred will generally come from the state officials who are directed to detect possible violations. *See* N.D. CENT. CODE §§ 10-06-10 to -12 (Supp. 1981). The legislative history indicates that the attorney general is to do more investigation of suspected violations after they are reported to him. *Senate Agricultural Hearings, supra* note 3 (February 12, 1981) (explanation of proposed amendment No. 12).

170. N.D. CENT. CODE § 10-06-13 (Supp. 1981).

171. *Id.*

172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.*

The one year divestment period does not allow a violating corporation much time to test the market in order to receive the highest possible price for the land. The legislative history indicates, however, that the running of the one year divestment period may be stayed until after any appeals have been made.<sup>176</sup> In either case, this provision may be a trap to the unwary corporation as well as punishment to a corporation trying to circumvent the law. It is likely, however, that prosecution forcing a family farm corporation out of business will affect only corporations that refuse to comply with the statute.<sup>177</sup>

The second type of judicial relief provided by statute is injunctive relief. The statute provides the following: “[A]ny prospective or threatened violation may be enjoined by an action brought by the attorney general in the manner provided by law including enjoining the corporation from completing performance on the remainder of any leasehold which is in violation of this chapter.”<sup>178</sup> Injunctive relief probably will not be used often by the attorney general. It will be easier for the attorney general to detect past violations through the records and reports that have to be filed with his office, the secretary of state, and the tax commissioner, than to learn of prospective violations. Injunctive relief will, however, be available when the attorney general knows that a corporation is preparing to challenge the corporate farming statute by an attempted violation. Injunctive relief also may be used when a family farm corporation plans to commence operations before the initial report is approved by the secretary of state.

The last type of judicial relief provided for is dissolution of the corporation. The statute allows for dissolution of the corporation in two situations — when the corporation fails to comply with the order of the district court after the corporation is found in violation of the corporate farming statute, and when a corporation continues to violate the provisions of the corporate farming act.<sup>179</sup>

The statute makes it clear that family farm corporations have to obey court orders or suffer dissolution.<sup>180</sup> The other situation calling for dissolution, continued noncompliance with the statute,

---

176. *House Agricultural Hearings*, *supra* note 5 (March 13, 1981) (statement of att’y William Guy). Attorney General Robert Wefald did not specifically mention appeals, but he stated that the divestment period would follow a lengthy legal process. *Id.* (comments of Att’y Gen. Robert Wefald).

177. Prosecution that would force a family farm corporation out of business will only affect corporations that refuse to comply with the statute. *Id.* (comments of Att’y Gen. Robert Wefald).

178. N.D. CENT. CODE § 10-06-13 (Supp. 1981).

179. *Id.*

180. *Id.* The statute is explicitly clear. It states, “[a]ny corporation that fails to comply with the court’s order shall be dissolved by the secretary of state.” *Id.*



indicates that the attorney general has other alternatives than proceeding in district court to force compliance. Such alternatives may include warnings and orders by the attorney general. The attorney general's power to dissolve a corporation that continually violates the provisions of the corporate farming statute is probably a remedy of last resort when no other method of compliance is available.

### 3. *Private Enforcement*

In addition to authorizing the state to proceed against family farm corporations that may be violating the corporate farming statute, enforcement by private citizens is authorized.<sup>181</sup> The private citizen is to proceed against the corporation in the same manner as the state proceeds.<sup>182</sup> Also, a successful suit by the private citizen entitles such plaintiff to reasonable attorney's fees from the defendant corporation, and the defendant must pay the costs of the action.<sup>183</sup> If the defendant corporation succeeds, however, the costs of the action and the defendant's reasonable attorney's fees shall be paid by the plaintiff.<sup>184</sup> If state officials are remiss in their enforcement of the corporate farming statute, private enforcement will be very important. The costs of the action and attorney's fees provisions encourage private citizens to bring suits with a reasonable chance of success, while discouraging suits brought with little chance of success or for the purpose of harassing a farm corporation.

All of the above-mentioned enforcement provisions are important if North Dakota is to have an effective corporate farming statute. The North Dakota statute, although narrowly written, will have opened the door for large scale corporate farming unless the statute is actively enforced by both the attorney general and private citizens.

---

181. *Id.* § 10-06-14. This section declares the following:

This chapter may be enforced in the same manner as provided in section 10-06-13 by any corporation authorized by this chapter or any resident of legal age of a county in which the land owned or leased by a corporation in violation of this chapter is located. If such action is successful, all costs of the action shall be assessed against the defendant and a reasonable attorney fee shall be allowed the plaintiff, and, should judgment be rendered for the defendant, such costs and a reasonable attorney fee for the defendant shall be paid by the plaintiff.

*Id.*

182. *Id.*

183. *Id.*

184. *Id.* Oklahoma's statute also provides that the unsuccessful party shall pay all costs of the action in addition to the successful party's reasonable attorney's fee. OKLA. STAT. ANN. tit. 18, § 953 (B) (West Supp. 1981-1982).

#### D. PROTECTION OF MINORITY SHAREHOLDERS

The last section of the North Dakota corporate farming statute provides the means of protecting the interests of the minority shareholders in a family farm corporation.<sup>185</sup> A family farm corporation is a closed corporation in that only members of the statutory group may be shareholders.<sup>186</sup> Because there is a limited market for the sale of shares of a closed corporation, the value of the shares may be difficult to determine.<sup>187</sup> As a result, minority shareholders may not be able to receive a fair price should they decide to withdraw from the corporation and sell their shares.<sup>188</sup>

To protect minority shareholders the North Dakota statute provides a method for disposing of the stock if there is not already a corporate plan to cover such a situation.<sup>189</sup> The minority shareholder is to offer the stock for sale to the other shareholders,

---

185. N.D. CENT. CODE § 10-06-15 (Supp. 1981). The full text of this provision states the following:

If a shareholder owns less than fifty percent of the stock of a farming or ranching corporation doing business under this chapter, and if the terms and conditions for the repurchase of that stock by the corporation or by the other shareholders are not set forth in the bylaws, the instrument which transferred the shares to the shareholder, or are not the subject of a shareholders' agreement or an agreement between that shareholder and the corporation, then the disposition of such stock shall be determined by this section upon the withdrawal of the shareholder. Any shareholder who desires to withdraw from the corporation shall first offer the shares of stock for sale to the remaining shareholders in proportion to the shares owned by them. In the event not all of the shareholders wish to purchase the stock, any one shareholder can purchase all of the withdrawing shareholder's stock. In the event no shareholder desires to purchase the stock of a withdrawing shareholder, then the corporation itself may purchase the stock. In the event the corporation chooses not to purchase the stock of the withdrawing shareholder, then the withdrawing shareholder may sell the stock to any other person eligible to be a shareholder. In the event the withdrawing shareholder is unable to sell the stock to any other person eligible to become a shareholder, then the withdrawing shareholder may bring an action in district court to dissolve the corporation. The court, upon a finding that the withdrawing shareholder cannot sell the stock at a fair price, shall enter an order directing that the corporation itself or any or all of the remaining shareholders pro rata or otherwise shall have twelve months from the date of the court's order to purchase the withdrawing shareholder's stock at a fair price as determined by the court and that if the stock of the withdrawing shareholder is not completely purchased at said price, the corporation shall be dissolved and the assets of the corporation shall be first used to pay all the liabilities of the corporation with the remaining net assets to be distributed pro rata to the shareholders in proportion to their stock ownership. For the purpose of this section, a "fair" price for the withdrawing shareholder's stock shall be determined as though the stock were being valued for federal gift tax purposes under the Internal Revenue Code of 1954, as amended.

*Id.*

186. A closed corporation is "a corporation whose shares, or at least voting shares, are held by a single shareholder or closely-knit group of shareholders." H. HENN, *HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* 506 (1970).

187. *Id.* at 552.

188. One state representative specifically mentioned that the provision protecting a minority shareholder's economic interest is worthwhile because relationships between family members are not always "love and roses." *House Agricultural Hearings, supra* note 5 (March 13, 1981) (comments of Rep. Backes).

189. N.D. CENT. CODE § 10-06-15 (Supp. 1981).

the corporation, or other persons eligible to be shareholders.<sup>190</sup> If the minority shareholder is unable to obtain a fair price for the stock from the parties to whom the stock was offered, the withdrawing shareholder may bring an action in district court to dissolve the corporation.<sup>191</sup> In the event the court finds the withdrawing shareholder cannot sell his shares at a fair price, the court shall set a fair price for the purchase of the minority shareholder's stock.<sup>192</sup> The corporation will be dissolved only when the withdrawing shareholder's stock is not completely purchased at the court-determined fair price.<sup>193</sup>

Many shareholders of a corporation overlook the fact that someday one or more of the shareholders may want to withdraw from the corporation.<sup>194</sup> This provision of the statute provides a method for an orderly sale of a minority stockholder's interest in the corporation, while assuring that the minority shareholder will receive a fair price. The importance of the provision is to protect a minority shareholder's economic interest in the corporation because the minority shareholder cannot control the management of the corporation.<sup>195</sup>

In summary, the 1981 North Dakota corporate farming statute now permits incorporation by farmers and ranchers provided that they meet each statutory requirement, including the kinship and numerical limits. The legislative assembly tried to draft a narrow bill that would be approved by the legislature and the people. The bill is now in effect, but its impact on North Dakota agriculture remains to be seen.

#### IV. EFFECTS OF THE CORPORATE FARMING STATUTE

Because the corporate farming statute became effective on July 1, 1981, as of this writing it is too early to tell how the corporate farming statute will affect agriculture in North Dakota. As of January 18, 1982, thirty-three farms and ranches had been incorporated.<sup>196</sup> In the future, by using the reports that must be

---

190. *Id.*

191. *Id.*

192. *Id.*

193. *Id.*

194. See *House Agricultural Hearings*, *supra* note 5 (March 13, 1981) (comments of Rep. Backes).

195. The legislative history indicates that the legislature included the provision for the protection of minority shareholders to force family farm corporations to be fair to all family members who are shareholders in the corporation. *Id.* (statement of North Dakota Att'y Gen. Robert Wefald).

196. Telephone interview with the secretary to Ben Meier, North Dakota Secretary of State (Jan. 18, 1982).

filed with state officials, the impact of the corporate farming statute should become apparent.<sup>197</sup>

Opponents of the North Dakota corporate farming statute expressed concern that by allowing corporate farming in North Dakota, farms and ranches will grow larger and become fewer in number.<sup>198</sup> Even before passage of the corporate farming act the trend in North Dakota had been toward fewer farms and increased farm size.<sup>199</sup> Supporters of the corporate farming act claimed that the economic benefits of incorporation would allow more family farms to remain operating over the next generations, thereby reversing the trend.<sup>200</sup> North Dakota can only wait and see.

The corporate farming act provides North Dakota farmers and ranchers with a new form in which to organize their farm or ranch businesses.<sup>201</sup> The needs of the individual farmer or rancher, as well as the advantages and disadvantages of using the corporate form, should be considered before the decision whether to incorporate is made. The factors to consider before incorporation of a farm or ranch are the same as those considered before incorporating any other business. The advantages of incorporation include income tax savings,<sup>202</sup> limited shareholder liability,<sup>203</sup> ease

---

197. To measure the impact of corporate farming and alien ownership of Nebraska agricultural land, Nebraska has a unique corporate farming statute in that it consists entirely of a requirement that corporations holding Nebraska agricultural land file an annual report. NEB. REV. STAT. §§ 76-1501 to -06 (1976).

198. The legislative history contains a statement by one farmer that incorporation would benefit the rich farmers who are rapidly expanding their operations to the disadvantage of farmers with small operations and beginning farmers. *Senate Agricultural Hearings, supra* note 3 (remarks of Charles Linderman).

199. Statistics for North Dakota show that in 1945 there were 69,520 farms averaging 590 acres, as compared to 1978 when there were 41,169 farms averaging 1021 acres. 2 U.S. DEP'T OF COMMERCE, 1978 CENSUS OF AGRICULTURE part 34, at 1 (1981).

200. *Senate Agricultural Hearings, supra* note 3 (comments of Rep. Olafson).

201. An excellent source of lengthy material to help farmers and ranchers decide whether or not to incorporate their agricultural operations is the multivolume treatise on Agricultural Law by Neil Harl. 7 N. HARL, AGRICULTURAL LAW (1981).

202. Through careful planning farm corporations should be able to achieve considerable tax advantages. Corporate income tax rates are generally lower than those paid by individual taxpayers. I.R.C. §§ 1, 11(b) (Supp. 3, 1981). Additionally, corporations may deduct reasonable costs incurred in doing business. *Id.* §§ 162, 163 (1978 & Supp. 3, 1981). These costs may include salaries, lease payments, and interest payments even when these payments are made to shareholders. *Id.* By allowing these deductions to the corporation, the effects of double taxation (taxation of income to the corporation and then again when distributed to the individual) are mitigated.

Double taxation is most likely to occur when a corporation is successful. When corporate income exceeds allowable deductions the corporation may distribute the profits as dividends to the shareholders, which will be doubly taxed, or it may retain them. Federal tax law permits the accumulation of \$150,000 in the corporation before imposing an accumulated earnings tax. *Id.* §§ 531-537 (1967 & Supp. 1981). It may be possible to accumulate additional amounts if there is a legitimate business reason for doing so. Treas. Reg. 1.537-2(b) (1959).

203. HARL, *supra* note 201, at § 51.02 (1). The liability of a shareholder in a corporation is generally restricted to the amount of his investment in the corporation. *Id.* If the farm or ranch corporation is operated too informally, limited liability may not be recognized, and the shareholders would be liable for all the debts and obligations of the business. *Id.*

in estate planning,<sup>204</sup> business continuity,<sup>205</sup> and other economic advantages.<sup>206</sup> Possible disadvantages of incorporation include the cost of incorporation,<sup>207</sup> formality of organization,<sup>208</sup> possible double taxation,<sup>209</sup> and adverse tax consequences upon dissolution.<sup>210</sup>

The number of farmers and ranchers who will take advantage of the North Dakota corporate farming law is uncertain.<sup>211</sup> It is probably the farmers and ranchers with large amounts of land and money who will benefit most from the tax advantages of incorporation.<sup>212</sup> North Dakota may want to equalize the benefits

204. HARL, *supra* note 201, at § 51.02 (2). The characteristics of a corporation that aid in estate planning include, among others, division of stock of the corporation while retaining control over the management of the corporation, divisibility of asset ownership into easily transferred shares, and the possibility of using corporate stock transfers to reduce income tax liability. *Id.*

205. HARL, *supra* note 201, at § 51.02 (3). Business continuity is an advantage inasmuch as with proper planning, the death of a shareholder will not jeopardize the continuation of a farm corporation as will the death of a member of a farm partnership. *Id.*

206. HARL, *supra* note 201, at § 51.02 (4). Economic advantages in addition to reduced income taxes include internal economic efficiency, simplified income accounting and record keeping, and the availability of additional capital. *Id.*

207. Costs of incorporation will include attorney's fees and state filing fees. N.D. CENT. CODE §§ 10-23-04 to -06 (Supp. 1981).

208. All North Dakota business corporations are subject to the provisions of the North Dakota Business Corporation Act and must comply with the procedures stated therein. N.D. CENT. CODE chs. 10-19 to -23 (1976 & Supp. 1981). For example, under the Act a corporation is required to hold annual and special shareholders meetings, *id.* § 10-19-26, to elect directors, *id.* § 10-19-37, to elect officers, *id.* § 10-19-49, and to file annual reports. *Id.* § 10-06-08 (Supp. 1981).

209. The corporation is considered an entity subject to federal income tax. I.R.C. § 11(a) (Supp. 3, 1981). The taxable income of individuals is also subject to income tax. *Id.* § 1 (Supp. 1981). As a result, where a corporation makes nondeductible income distributions to individuals, the income will be taxed twice—once as income to the corporation, and once as income to the individual. The most common method used to avoid the possibility of double taxation is to distribute income to individuals in the form of salaries which are deductible to the corporation rather than in the form of dividends which are not. *See supra* note 186.

210. Incorporation of a business is usually considered a tax free exchange. I.R.C. § 351 (1978). In order to be a tax free exchange, the property must be "transferred to a corporation solely in exchange for stock or securities in such corporation. . . ." *Id.* Additionally, the transferees of the property must be in control of the corporation immediately following the transfer. *Id.* Control is defined as "the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation." *Id.* § 368(c). Therefore, in most cases it is possible to incorporate so as to incur no tax liability. The tax consequences of dissolution, on the other hand, may be severe. It is therefore important to plan carefully. *See HARL, supra* note 201, at § 51.02(5).

Three options exist for handling gains and losses, including those incurred upon dissolution. I.R.C. §§ 331, 333, 337 (1978 & Supp. 1981). As a general rule, cash and property received by shareholders in excess of their basis in the property will result in taxable gain to the shareholders. *Id.* § 301(c)(3)(A) (1978). The gain received in this manner is usually taxed at capital gains rates. *Id.* §§ 1221-1223 (1967, Supp. 1981 & Supp. 3, 1981). If, however, undistributed earnings of the corporation are treated as ordinary income, some assets may be received by the shareholder without the recognition of any gain. *Id.* § 333 (1978).

Problems upon dissolution occur most often when the corporation holds assets that have greatly appreciated in value, for example land. When the corporation dissolves, the shareholders have the potential for recognizing substantial gain. Additionally, the corporation may incur a tax liability upon dissolution. *See, e.g.,* I.R.C. §§ 336-338 (1978 & Supp. 1981). It is therefore advisable not to make farm land a corporate asset.

211. One of the cosponsors of the corporate farming statute acknowledged that incorporation would not be advisable for all farmers and ranchers. *Senate Agricultural Hearings, supra* note 3 (February 6, 1981) (statement of Sen. Iszler).

212. *See* Guy, Advantages and Disadvantages of Corporation Farming 1-2 (presented to the North Dakota Leg. Assembly on Jan. 29, 1981) (unpublished paper included in the legislative history of the corporate farming statute, N.D. CENT. CODE ch. 10-06 (Supp. 1981)). As income increases

that accompany incorporation by making the benefits available to all farmers and ranchers, not just those who qualify as a family farm corporation. Other states provide such a plan by allowing small numbers of unrelated shareholders to incorporate for the purpose of engaging in the business of farming or ranching.<sup>213</sup>

One benefit from the corporate farming act should be that farmers and ranchers in North Dakota will be consulting with business professionals, such as lawyers and accountants, to determine if incorporation will be beneficial to the particular agricultural operation. There are still those farmers and ranchers who resent input from the business world in the field of agriculture. As time goes on and farming techniques become even more modern, farmers and ranchers must utilize modern business techniques. The agricultural operation is more like the traditional business world than ever before. Discussions with business professionals can only advance that trend.

The cynical approach to North Dakota's 1981 corporate farming statute would be that the act is only lip service to what is intended. The act is supposed to help the farmer and rancher by giving him or her the same rights as other businessmen and women.<sup>214</sup> The statute is drawn narrowly, however, and will probably help only a limited number of farmers and ranchers. Only time will tell what effect the corporate farming statute will have on the state of North Dakota.

## V. CONCLUSION

The 1981 North Dakota Legislature passed a bill that allows certain farmers and ranchers to incorporate. This changed the law that had been in effect since 1932 which prohibited corporate farming in North Dakota. The 1932 law had been enacted to prevent corporations, especially lending institutions, from owning

---

above \$25,000, the income tax savings from operating the farm or ranch as a family farm corporation rather than as a sole proprietorship increase. *See* Guy, *supra*.

213. *See, e.g.*, S.D. CODIFIED LAWS ANN. § 47-9A-15 (Supp. 1981). The South Dakota statute provides for authorized farm corporations as follows:

As used in this chapter, unless the content otherwise plainly requires, "authorized farm corporation" means a corporation whose shareholders do not exceed ten in number, whose shareholders are all natural persons or estates, whose shares are all of one class, and whose revenues from rent, royalties, dividends, interest and annuities do not exceed twenty percent of its gross receipts.

*Id.* Authorized farm corporations generally receive the same treatment as family farm corporations. "The restrictions of § 47-9A-3 shall not apply to a family farm corporation or an authorized farm corporation." *Id.* § 47-9A-13.

214. *Senate Agricultural Hearings, supra* note 3 (January 29, 1981) (comments of Rep. Olafson).

or leasing North Dakota farm land. The new corporate farming act is narrowly drawn, so that large corporations still cannot control agricultural lands in North Dakota. This new law allows North Dakota farmers and ranchers to benefit from the corporate business form if they meet the statutory requirements. There is a numerical limit of fifteen members or shareholders. All shareholders or members have to be related to a certain degree. At least one shareholder or member must reside on or operate the farm or ranch. The officers and directors must be actively engaged in operating the farm or ranch. There are limits on the amount of outside income that may be realized by the corporation. The corporation must keep certain records and file certain reports with the state government. The attorney general is the state official designated to enforce the statute; however, there is a provision for enforcement by the private citizens of North Dakota. Only the passage of time will determine if the allowance of corporate farming and ranching in North Dakota will be the useful business tool that the farmers, ranchers, and legislators of North Dakota hope it will be.

ROSS H. ESPESETH