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MacDonald, The Family: How Are You Going To Keep Them Down On The Farm

THE FAMILY: HOW ARE YOU GOING TO KEEP THEM DOWN ON THE FARM?

Don MacDonald

INTRODUCTION

Those who labor in the earth are the chosen people of God, if ever He had a chosen people, whose breasts He has made His peculiar deposit for substantial and genuine virtue'. . . .

Cultivators of the earth are the most valuable citizens. They are the most vigorous, the most independent, the most virtuous, and they are tied to their country and wedded to its liberty and interests, by the most lasting bonds.²

These words of Thomas Jefferson, although nearly two centuries old, underscore a policy which still evokes considerable sympathy throughout America: the need for preservation of the family farm. Since Jefferson's time, this nation as a whole has shifted from a primarily rural farming populace to an urban-dwelling one. In Montana alone, the decrease in the number of farms has been dramatic. In 1920, for instance, Montana had over 57,000 farms.³ In 1969 that figure had been reduced to 24,951.⁴ Corresponding with this decrease in number, there has been an increase in size of the average Montana farm from 608.1 acres in 1920⁵ to 2,521 in 1969⁶ as well as an increase in the use of the corporate form in agriculture.⁷ In an effort to combat this trend, several states have enacted legislation aimed at preserving the family farm⁸ and several more, including Montana, have been considering such legislation.⁹ The purpose of this comment is to determine, in general, the desirability of such legislation by: (1) briefly exploring three major reasons for

¹T. Jefferson, NOTES ON VIRGINIA 157 (1782).

²Letter from Thomas Jefferson to John Jay, August 23, 1785.

³Department of Commerce, 1, (pt. 27) 1954 CENSUS OF AGRICULTURE, 2. (Hereinafter cited as 1954 CENSUS OF AGRICULTURE.)

⁴Department of Commerce, 1, (pt. 38) 1969 CENSUS OF AGRICULTURE, 1. (Hereinafter cited as 1969 CENSUS OF AGRICULTURE.)

⁵1954 CENSUS OF AGRICULTURE, *supra* note 3.

⁶1969 CENSUS OF AGRICULTURE, *supra* note 4.

⁷According to the 1969 Census of Agriculture, fifty-three Montana farm corporations owned 823,562 acres of land while one hundred and ninety-five sole proprietorships and thirty-seven partnerships owned a total of 813,429 acres. These were the totals for all Montana farms with incomes of greater than \$2,500. Thus, farm corporations are really the dominant form of farm ownership today in Montana. See also Harl, *The Farm and Ranch Corporation—Business Organizational Form of the Future*, 43 NEB. L. REV. 365 (1963).

⁸NORTH DAKOTA CENTURY CODE § 10-06-01 (1960) (hereinafter cited as N. D. CENT. CODE (1960)); KANSAS STATUTES ANNOTATED § 17-6002 (1963) (hereinafter cited as KAN. STAT. ANN. (1963)); VERNON'S ANNOTATED TEXAS STATUTES BUSINESS CORPORATIONS ACT art. 2.01(B)(3)(a) (1956) (hereinafter cited as TEX. STAT. BUS. CORP. ACT (1956)); MINNESOTA STATUTES ANNOTATED § 500.22(3) (1947) (hereinafter cited as MINN. STAT. ANN. (1947)); OKLA. CONST. art. XXII, § 2.

⁹For a good discussion of these proposals, see Comment, *Proposed Anticorporate Farm Legislation*, 1972 WIS. L. REV. 1189 (1972) and Harl, *Farm Corporations—Present and Proposed Restrictive Legislation*, 25 BUS. LAWYER 1247 (1970).

the decline of the family farm;¹⁰ (2) examining existing provisions in other states dealing with family farms; (3) scrutinizing the proposed Montana legislation, House Bill 132; and, (4) discussing the considerations that should be reviewed in a policy favoring family farms.

FACTORS CAUSING THE DECLINE OF THE FAMILY FARM

(A) THE INDUSTRIALIZATION OF AGRICULTURAL METHODS

The increasing use of farm machinery has been a major factor in the decline of the small family farm and the consequent increase in large-scale agriculture. As one expert has noted, "Machinery makes it quite advantageous to move into larger production."¹¹ Larger production means larger farms and fewer people. The nearly fourfold increase in the size of farms between 1920 and 1969¹² illustrates the effect of larger-scale machinery on the size of farms. While using more machinery over larger areas does not necessarily mean that an industrialized farm will be more efficient than its family counterpart in a particular case, "big farms and ranches generally have been more efficient (than small farms and ranches). Their cost per bushel and cost per pound is lower."¹³ According to one writer, the trend to larger, more industrialized farms is just beginning:

The trend towards larger farms seems to be inevitable as a consequence of presently known technology. In fact, at least a doubling (perhaps even a tripling) in average farm size would be in prospect if presently known technology were fully applied. Whether technological advances in the future will further promote farm consolidation remains to be seen but it is doubtful if the trend will be reversed. Unless research and development expenditures are curtailed, a substantial tax is imposed on tractors above 120 horsepower in size, or it becomes a crime to manufacture large scale equipment, developing technology is likely to result in additional increases in the size of firm (sic). Rising wage levels and increasing opportunity costs for family labor encourage the substitution of capital for labor and thus promote large scale equipment.¹⁴

Thus, the increased efficiency of industrialized farms has been a significant factor in the decline of the family farm.

(B) VERTICAL INTEGRATION

Vertical integration is another factor that many believe has led to the decline of the family farm.¹⁵ A business that is vertically integrated is one which performs several production processes in the chain

¹⁰The author is well aware that there may be considerably more than three factors contributing to the decline of the family farm. For the sake of brevity a prolonged discussion of these many factors has been avoided.

¹¹Dr. Richard McConnen as quoted in *The Sunday Missoulian*, May 27, 1973, at 22 col. 1.

¹²1954 CENSUS OF AGRICULTURE, *supra* note 3. 1969 CENSUS OF AGRICULTURE, *supra* note 4.

¹³Dr. Richard McConnen, *supra* note 11 at 22 col. 2.

¹⁴Harl, *supra* note 9 at 1257.

¹⁵For an excellent discussion of vertical integration in farming, see Comment, *Proposed Anticorporate Farm Legislation*, 1972 WIS. L. REV. 1195 (1972).

of events leading from a raw material to a finished product. Instead of competing with other businesses at different stages of the economic process in an open market, the integrated company merely hands over the products from one division to another. A classic example of a vertically integrated company is a modern steel corporation. The corporation owns the mining company that mines the iron, the barge company that hauls the ore, the railroad that takes the ore from the barge to the smelter, the smelter, the company that makes the equipment used in the smelter, and the company that commercially distributes the steel once it has been manufactured. Montanans have an example of vertical integration right in their own backyard: the Anaconda Company operates the Butte, Anaconda, and Pacific Railroad to transport ore in the Butte area.

The chief advantage of vertically integrating a company is that it "[M]ay result in greater economies by combining different production stages and regularizing supplies, thereby increasing profit margins."¹⁶ Thus, a vertically integrated farm corporation can often operate more efficiently than its nonintegrated counterpart because it can combine production stages and regularize supplies. A vertically integrated wheat farm could not only own the land and the equipment on the farm but also have subsidiaries that produce fertilizers, make farm equipment, transport the grain, and market the final product. The family farmer, on the other hand, has to buy from independent businesses at each stage of the production process. He must purchase fertilizer from a fertilizer dealer at full retail prices; pay the equipment dealer full list price for farm equipment and so on down the line. Because of the economies realized from vertically integrating, the family farmer is placed at an economic disadvantage which could lead to his eventual downfall.

Although vertical integration has been recognized as one cause in the decline of the family farm, the extent of it still remains somewhat of a mystery. Currently, neither the Census of Agriculture nor the Montana Department of Agriculture has any statistics accurately reflecting the number of vertically integrated agricultural farms in Montana.¹⁷

(C) FEDERAL TAX ADVANTAGES

Farmers who have no large nonfarm income often find themselves competing with "fatcats" having a large nonfarm income and who seek to use their farming or ranching operations as a tax shelter.¹⁸ Be-

¹⁶M. SPENCER, *CONTEMPORARY ECONOMICS* 472 (1971).

¹⁷This problem was also pointed out in a news item entitled, *Controversy Still Rages Over Corporate Farming*; found in *The Sunday Missoulian*, May 27, 1973, at 22 col. 1.

¹⁸For a detailed analysis of farm tax advantages, see Allington, *Farming as a Tax Shelter*, 14 S.D.L. REV. 181 (1969) and Axelrad, *Farming as a Tax Shelter: Citrus Groves and Breeding Herds*, 46 TAXES 12 (1968).

cause of the tax advantages to be realized from this situation, the person possessing a large nonfarm income can lose money on his farm and still be making a substantial profit. As one writer has pointed out:

While investors are not prone to put their money into losing ventures, it is entirely possible that a farm investment could show a net loss for tax purposes in a particular year even though a profit can be expected from an economic standpoint. The taxpayer who has a relatively high income from another source can realize a substantial tax savings by deducting these losses from his nonfarm income. . . .¹⁹

Faced with competitors who can afford to take losses, the family farmer with no nonfarm income is often placed at a severe disadvantage.

The farming "tax shelter" is based on two concepts: (1) the choice between deductions and capitalization available to farmers and (2) the use of capital gains treatment. When increasing the value of capital assets in most industries, the Internal Revenue Code requires that such disbursements be charged against capital accounts.²⁰ Farmers are in the unique position of being able to choose whether to deduct or capitalize several of their expenditures that may benefit them at some future time. Such things as soil and water conservation expenditures,²¹ expenditures for materials such as fertilizer, lime, or other materials which enrich or condition the soil,²² and expenditures incurred in clearing land²³ can either be deducted or capitalized. As several writers have noted, a similar tax advantage is available to livestock owners.²⁴ The significant part of the livestock regulation provides:

The purchase of feed and other costs connected with raising livestock may be treated as expense deductions insofar as such costs represent actual outlay. . . .²⁵

Thus, farmers and livestock owners are both in the enviable position of being able to choose whether to capitalize or deduct expenditures in several areas.

Although the ability to deduct or capitalize expenditures is a significant advantage, in reality it does not reduce the tax burden but only defers it to another time. Use of capital gains provisions, the second concept mentioned above, combined with the ability to make a choice between deduction and capitalization is one way to avoid the payment of some taxes altogether. Consider the following example. A wealthy taxpayer in an income tax bracket of 70% purchases some calves and plans to raise them. He takes advantage of the choice between capitalization and deduction and deducts all the expenses involved in the trans-

¹⁹Allington, *supra* note 18 at 183.

²⁰INT. REV. CODE OF 1954, § 263.

²¹*Id.* § 175.

²²*Id.* § 180.

²³*Id.* § 182.

²⁴Allington, *supra* note 18 at 182, and Axelrad, *supra* note 18 at 785.

²⁵52 Fed. Reg. 40,152 (1987).

action. Since there is no income realized until the sale of the cattle, the taxpayer suffers a net loss on the transaction. Thus, if the herd cost \$300,000 to feed and maintain, the taxpayer could deduct the \$300,000 loss from his income. Taking 70% of this figure, the taxpayer would save \$210,000 in income taxes for the year or years in question. If the taxpayer complied with the capital gains provision of the Internal Revenue Code²⁶ and held the cattle for draft, breeding, or dairy purposes for twenty-four months, he would be entitled to long-term capital gains treatment with a maximum tax of 25%.²⁷ If the cattle, which are considered capital assets, were sold for \$300,000, the maximum capital gains tax would be \$75,000. Thus, our wealthy taxpayer could realize a tax savings of \$135,000 through the use of the capital gains provisions and the election to deduct rather than capitalize expenditures,

Although the tax shelter available through capital gains and choice of capitalization or deduction of expenditures is available to corporations²⁸ as well as other types of businesses,²⁹ the Internal Revenue Code has recently enacted provisions that restrict the use of this shelter. One new section provides that capital expenditures incurred in planting and developing citrus and almond groves³⁰ can no longer be treated as deductible expenditures.³¹ Another new section limits the advantages gained by use of soil and water conservation expenditures and land clearing costs that were previously deducted.³² Under this provision the expenditures are recaptured³³ if the farmland involved is sold within five years of the date that it was acquired.³⁴ A third new section³⁵ applies to taxpayers claiming a net farm loss. Through an elaborate system that requires the setting up of an "excess deductions account," the section limits the amount of expenditures deductible from nonfarm income. Once the farm property is sold at a gain, the excess deductions³⁶ are treated as ordinary income and taxed as such. However, the taxpayer still has the advantage of a \$25,000 regular deduction per year³⁷

²⁶INT. REV. CODE OF 1954, § 1231(b)(3).

²⁷*Id.* § 1201.

²⁸*Id.* § 1201(a).

²⁹Section 1231 of the Internal Revenue Code gives capital gains treatment to: (1) Timber, coal, or domestic iron ore which apply to section 631, (2) Livestock, other than cattle or horses held by the taxpayer for draft, breeding, dairy, or sporting purposes for at least 12 months, (3) Unharvested crops on land held for more than six months if the crops and the land are sold at the same time to the same person.

³⁰This provision "supersedes" the article by Axelrad, *supra* note 18.

³¹INT. REV. CODE OF 1954, § 278.

³²*Id.* § 1252.

³³Recaptured means that the expenditures will be treated as gross income when the farm is later sold.

³⁴Under section 1252 of the Internal Revenue Code, land sold after six years has an 80% recapture provision; after seven years 60% recapture, and so on down to ten years with no recapture.

³⁵INT. REV. CODE OF 1954, § 1251.

³⁶Excess deductions are those of over \$25,000 a year. See § 1251(b)(2)(B)(ii) of the Internal Revenue Code.

as well as the use of his tax monies until the farm is sold.³⁸ Hence, there is still a considerable incentive to use farming as a tax shelter although some of the greater advantages have been recently toned down.

FAMILY FARM PROVISIONS IN OTHER STATES

(A) NORTH DAKOTA

North Dakota is the only state in the union that flatly prohibits any type of farm corporation.³⁹ Nonfarm corporations can, on the other hand, own the amount of real estate "reasonably necessary" for carrying on the purpose for which the corporation was formed.⁴⁰ All corporations in North Dakota, both foreign and domestic, were given ten years from the date of passage of the act prohibiting farm corporations to dispose of their rural properties or the land was to be sold at a public auction by the local county with the proceeds going to the corporation.⁴¹ Farm cooperative corporations with five or more adults are exempt from the act when 75% of their members reside on farms or depend principally on farming for their livelihood.⁴²

The reason behind this strict prohibition of farm corporations was a fear that North Dakota land would be taken over by mammoth corporations during the great depression.⁴³ As one writer pointed out:

At the time of its adoption (1932) by the people of this state, North Dakota was at the bottom of the great depression, and I believe it safe to say that the Act was aimed in large measure at life insurance companies and outside corporate lenders which had foreclosed on thousands of acres of North Dakota agricultural land.⁴⁴

Surprisingly enough, this strict rule has not been the subject of much litigation, although it has caused considerable controversy in the state legislature. In two court challenges the Act has been upheld as constitutional, not only by the North Dakota supreme court,⁴⁵ but also by the United States Supreme Court.⁴⁶ The state legislature, after some

³⁸The \$25,000 a year deduction could still result in substantial savings to people in high tax brackets. For someone in the 70% bracket, for instance, a tax savings of \$11,250 a year could be realized by using this deduction. Over a period of time this could amount to a substantial tax savings indeed.

³⁹N. D. CENT. CODE § 10-06-01 (1960).

⁴⁰The "reasonably necessary" provision is found in N. D. CENT. CODE § 10-06-02 (1960). For a discussion of what it means, see *Loy v. Kessler*, 76 N. D. 738, 760-761, 39 N.W.2d 260 (1949) and *McElroy, North Dakota's Anti-Corporate Farming Act*, 36 N.D. L. REV. 96 (1960).

⁴¹N. D. CENT. CODE § 10-06-05 (1960).

⁴²N. D. CENT. CODE § 10-06-04 (1960).

⁴³This is the thesis of a student writer in Comment, *An Analysis of House Bill 782: The Latest Attempt to Repeal North Dakota's Ban on Corporate Farming*, 44 N.D. L. REV. 255 (1967).

⁴⁴McElroy, *supra* note 40.

⁴⁵*Coal Harbor Stock Farm, Inc. v. Meier*, 191 N.W.2d 583 (N.D. 1971).

⁴⁶*Asbury Hospital v. Cass County*, 73 N.D. 469, 16 N.W.2d 523 (1944), *aff'd* 326 U.S. 307

prodding by local legal writers,⁴⁷ finally voted to repeal the Act and authorize farm corporations which meet specified requirements⁴⁸ patterned after the Subchapter S requirements of the Internal Revenue Code.⁴⁹ These requirements were: (1) the corporation could have no more than 10 shareholders; (2) the corporation's shareholders all had to be individuals or the estates of individuals; (3) the corporation could have no more than one class of stock; and, (4) the corporation's net income from rents, royalties, dividends, interest, and annuities could not exceed 20% of the corporation's gross receipts.⁵⁰ The governor later vetoed this act, but was overridden by a two-thirds vote of the North Dakota house and senate.⁵¹ Finally, the bill was submitted to a referendum vote of the North Dakota voters and was defeated.⁵² Thus, North Dakota's complete prohibition of farm corporations is still in effect.

(B) KANSAS

Although Kansas flatly prohibited some types of farm corporations for over thirty years, recently the state has relaxed some of its limitations.⁵³ The original law prohibited farm corporations if certain crops were raised or the corporation engaged in dairy farming.⁵⁴ Neither local nor foreign corporations could be given permission to do business in the state for the purpose of:

[E]ngaging in the agricultural or horticultural business of producing, planting, raising, harvesting, or gathering of wheat, corn, barley, oats, rye, or potatoes, or the milking of cows for dairy purposes.⁵⁵

The new law, enacted in 1965, adds grain sorghum to the list of prohibited crops. It permits, however, the production of prohibited crops provided: (1) the corporation has no more than ten shareholders who must be individuals or natural or corporate trustees under trust instruments wherein individuals are primary beneficiaries, guardians, conservators, executors, or administrators; (2) all incorporators are Kansas residents; (3) the corporation, neither directly nor indirectly, owns, controls, manages, or supervises a total of more than five thousand acres of land; and, (4) none of the shareholders own stock in another corporation authorized to engage in the prohibited purposes.⁵⁶ Thus, although Kansas does not have a complete prohibition against all cor-

⁴⁷McElroy, *supra* note 40, and O'Keefe, *The North Dakota Anti-Corporate Farming Act: A Dissenting Opinion*, 41 N.D. L. REV. 332 (1964).

⁴⁸North Dakota Session Laws (1967), Ch. 97.

⁴⁹INT. REV. CODE OF 1954, §§ 1371-1378.

⁵⁰North Dakota Session Laws (1967), Ch. 97.

⁵¹NORTH DAKOTA HOUSE JOURNAL 962 (1967), NORTH DAKOTA SENATE JOURNAL 877 (1967).

⁵²Harl, *supra* note 9 at 1250.

⁵³Kansas relaxed the limitations in 1965. See the Kansas Session Laws (1965), Ch. 149.

⁵⁴KAN. STAT. ANN. § 17-202 (a), 2701 (1963).

⁵⁵KAN. STAT. ANN. § 17-6001 (1963).

⁵⁶KAN. STAT. ANN. § 17-6002 (1963).

porate farming, its laws do considerably confine corporate activities in that area.

(C) MINNESOTA

Minnesota has a statute which limits the amount of land a farm corporation can acquire for farming operations. The relevant portion of the statute reads: "[N]o corporation organized for and engaged in any farming operations, shall acquire more than 5,000 acres of land."⁵⁷ Just what "acquire" means apparently has sparked some controversy,⁵⁸ and the 1971 Minnesota legislature has passed a law requiring all farm corporations to submit an annual report listing the land owned or leased by the corporation for the purpose of growing crops or keeping or feeding poultry or livestock.⁵⁹ As of now, however, this report has not caused any changes in the 5,000-acre limitation in Minnesota.⁶⁰

⁵⁷MINN. STAT. ANN. § 500.22(3) (1947).

⁵⁸See Harl, *supra* note 9 at 1251.

⁵⁹MINN. STAT. ANN. § 500.23 (1947).

⁶⁰The following is a list of minor provisions in other states aimed at the preservation of the family farm.

Texas. Texas places restrictions upon corporate vertical integration in the cattle industry. Under the Texas Business Corporations Act, no corporation can be organized in Texas or transact business in Texas if it is engaged in the two following businesses: "[T]he business of raising cattle and owning land therefor, and the business of slaughtering, refrigerating, canning, curing, or packing meat." TEX. STAT. BUS. CORP. ACT. art. 2.01 (B)(3)(a) (1956). Operating a feed lot is not considered to be "the business of raising cattle and owning land therefor" and consequently is not prohibited. Thus, a meat packer could own a feed lot under the Texas law. Other than this restriction on the cattle industry, Texas imposes no restrictions on agricultural corporations and freely allows corporate participation in farming. TEX. STAT. BUS. CORP. ACT. art. 2.01(A) (1956).

Oklahoma. Oklahoma's constitution was once thought to completely prohibit corporate ownership of farmland. Cavanaugh, *State Limitations on the Size and Existence of Agricultural Corporations*, 15 BUS. LAWYER 900 (1960). Recent decisions by the Oklahoma supreme court indicate that the constitution does not prohibit farm corporations from owning land. *LeForce v. Bullard*, 454 P.2d 297 (Okla. 1969); *Oklahoma Land and Cattle Co. v. State*, 456 P.2d 544 (Okla. 1969). The relevant portion of the Oklahoma constitution reads:

No corporation shall be created or licensed in this state for the purpose of buying, acquiring, trading or dealing in real estate other than real estate located in incorporated cities and towns and as additions thereto; nor shall any corporation . . . deal in real estate for any purpose . . . except such as necessary and proper for carrying on the business for which it was chartered and licensed. . . .

OKLA. CONST. art. XXII, § 2. On its face, this confusing constitutional provision seems to prohibit any corporate ownership of land outside of incorporated cities and towns. However, in *LeForce v. Bullard*, *supra*, the Oklahoma supreme court held that a corporation could be formed in Oklahoma for the purpose of engaging in farming with the power to own real property outside the limits of incorporated cities and towns. As it now appears, Oklahoma places no restrictions upon corporate ownership of land for farming purposes.

Other States. Mississippi had a provision similar to that of Minnesota which limited the total acreage available to a corporation for agricultural purposes to 12,500 acres. MISSISSIPPI CODE ANNOTATED § 5329 (1942). This was later repealed, and no acreage restrictions now exist. Mississippi Laws (1962), Ch. 235, § 149.

West Virginia subjects all corporations with land holdings over 10,000 acres to a special tax of five cents per acre. WEST VIRGINIA CODE ANNOTATED § 11-12-75 (1966). This goes for a special certification that authorizes the corporation to hold

HOUSE BILL 132: AN EXAMINATION

(A) WHAT IS HOUSE BILL 132?

House Bill 132,⁶¹ as originally proposed, sought to limit corporate participation in farming through a restriction on the number of shareholders in a farming corporation. The bill proposed to limit the number of shareholders in a farm corporation to ten, similar to the proposed North Dakota law⁶² and the present Kansas statute.⁶³ The original proposal also provided that the ten shareholders had to be natural persons, estates, trustees for natural persons, banks with either their principle place of business in Montana or that are organized in this state, and corporations having no more than ten shareholders. The proposal also called for involuntary dissolution of a farm corporation organized after the effective date of the act that failed to comply with the act. The original proposal failed to include other restrictions that are found in the Subchapter S requirements of the Internal Revenue Code.⁶⁴ Restrictions such as requiring one class of stock and not allowing a nonresident alien to be a shareholder were excluded from the original bill.⁶⁵

House Bill 132, as amended, is a complete departure from the original proposal.⁶⁶ Instead of limiting corporate farming through re-

Other states, such as Montana currently, do not impose any restrictions upon farm corporations, but several are considering such legislation. Harl, *supra* note 9 at 1253.

⁶¹House Bill No. 132, introduced by Edland, Prevost, Murphy, Norman, Kolstad, Kimble, Jacobsen, Gunderson, Fleming, Schye, and Lund in the 43rd Legislative Assembly, 1973. The text of the original bill is deleted, but the full text of the bill as amended is included in note 66.

⁶²North Dakota Session Laws (1967), Ch. 97.

⁶³KAN. STAT. ANN. § 17-6002 (1963).

⁶⁴INT. REV. CODE OF 1954, §§ 1371-1378.

⁶⁵These two restrictions are found in the INT. REV. CODE OF 1954, § 1371(a)(3)-(4).

⁶⁶The following is the complete text of House Bill 132, as amended, and introduced in the 43rd legislative assembly in 1973.

A BILL FOR AN ACT ENTITLED: "AN ACT TO BE KNOWN AS THE 'MONTANA FAMILY FARM ACT OF 1973'; AND PROVIDE AN EFFECTIVE DATE. BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF THE STATE OF MONTANA:

SECTION 1. THIS ACT SHALL BE KNOWN AS THE "MONTANA FAMILY ACT OF 1973."

SECTION 2. IT IS HEREBY DECLARED TO BE THE PUBLIC POLICY OF THE STATE: IT IS DESIRABLE TO PRESERVE FREE, PRIVATE ENTERPRISE, TO PROTECT SMALL BUSINESS AND PREVENT MONOPOLY, AND TO PROTECT OPPORTUNITY FOR FAMILY FARMERS IN THE STATE, AS WELL AS TO PROTECT CONSUMERS. VERTICAL INTEGRATION OF THE AGRICULTURAL INDUSTRY BY THE PROCESSING, DISTRIBUTING, AND RETAILING INDUSTRIES AND CONGLOMERATE BUSINESSES HAS CREATED SITUATIONS OF UNFAIR, MONOPOLISTIC COMPETITION FOR THE FAMILY FARMER. THIS SITUATION HAS CONTRIBUTED TO THE DECLINE OF RURAL POPULATIONS AND THE CONSEQUENT CROWDING OF METROPOLITAN CENTERS. IT HAS RESULTED IN A NOTICEABLE DECLINE IN COMPETITIONS (sic) IN SOME PHASES OF AGRICULTURAL PRODUCTION AND THREATENS OTHERS. IT IS STATE POLICY TO RESTORE COMPETITION TO THE AGRICULTURAL INDUSTRY AND TO PROMOTE THE WELL-BEING OF THE MONTANA FAMILY FARM.

SECTION 3. AS USED IN THIS ACT, UNLESS THE CONTEXT OTHERWISE REQUIRES:

(1) "AGRICULTURE" MEANS THE CULTIVATION OF THE GROUND, THE HARVESTING OF CROPS, THE PRODUCTION OR THE RAISING OF PLANTS OR ANIMALS USEFUL TO MAN, OR ANY COMBINATION THEREOF, BUT DOES NOT INCLUDE LIVESTOCK IN FEEDLOTS. LIVESTOCK MEANS CATTLE, SHEEP, OR SWINE ARE CORRALED, HOUSED, OR PENNED, OR OTHERWISE CONFINED FROM GRAZING, AND THE PURPOSE OF SUCH CONFINEMENT IS TO FATTEN THE CATTLE, SHEEP, OR SWINE FOR SLAUGHTER AND NOT TO RETURN THEM TO GRAZING.

(2) "AGRICULTURAL LAND" MEANS ANY RURAL REAL ESTATE WHICH IS USED OR USABLE FOR THE BUSINESS OF AGRICULTURE.

(3) "NONAGRICULTURAL BUSINESS" MEANS A BUSINESS IN WHICH MORE THAN FORTY PERCENT (40%) OF THE BUSINESS' ANNUAL GROSS RECEIPTS OR ONE HUNDRED THOUSAND DOLLARS (\$100,000) OF ITS ANNUAL GROSS RECEIPTS, BASED ON A THREE (3) YEAR AVERAGE, WHICHEVER IS LARGER, IS FROM ANY SOURCE OTHER THAN AGRICULTURE, OR OTHER THAN ALLOWING OTHERS TO EXTRACT FROM THE AGRICULTURAL LANDS OF THE BUSINESS ANY MINERALS UNDERLYING THE SAME, INCLUDING, BUT NOT LIMITED TO, OIL, GAS, OR COAL.

(4) "CORPORATION" INCLUDED BUSINESS ASSOCIATIONS, JOINT-STOCK COMPANIES, AND BUSINESS TRUSTS.

(5) "PARTNERSHIP" INCLUDED A SYNDICATE, GROUP, POOL, JOINT VENTURE, OR OTHER UNINCORPORATED ORGANIZATION, THROUGH OR BY MEANS OF WHICH ANY BUSINESS, FINANCIAL OPERATION, OR VENTURE IS CARRIED ON.

SECTION 4. NO PERSON, PARTNERSHIP, CORPORATION, TRUST, OR CONGLOMERATE BUSINESS ENTITY ENGAGED IN NONAGRICULTURAL BUSINESS ANY WHERE AND OWNING OR CONTROLLING ASSETS AMOUNTING TO MORE THAN THREE MILLION DOLLARS (\$3,000,000) OR OWNING OR CONTROLLING STOCK OR OTHER SHARE OF CAPITAL WITH A TOTAL VALUE OF ONE MILLION DOLLARS (\$1,000,000) OR MORE, IN ONE OR MORE BUSINESS ENTITIES, SUCH AS, BUT NOT LIMITED TO, THOSE CORPORATIONS ENGAGED IN THE MEAT OR POULTRY PACKING BUSINESS OR THE WHOLESALING OR RETAILING OF RED MEAT, POULTRY OR LIVESTOCK PRODUCTS, INCLUDING DAIRY PRODUCTS OR ENGAGED IN THE PROCESSING, PURCHASING, SELLING, OR HANDLING OF GRAIN OR OTHER FIELD CROPS, INCLUDING FRUITS, VEGETABLES, PULSES, OR ANIMAL FEEDS; OR ENGAGED IN THE PRODUCTION, SALE, OR DISTRIBUTION OF AGRICULTURAL CHEMICALS AND FERTILIZERS OR PETROLEUM PRODUCTS; OR ENGAGED IN THE MANUFACTURE, SALE, OR DISTRIBUTION OF FARM SUPPLIES, INCLUDING MACHINERY, BUILDINGS, FENCING, OR OTHER EQUIPMENT; OR ENGAGED IN THE BUSINESS OF INSURANCE, BANKING, MONEY LENDING OR EXTENSION OF REAL ESTATE OR PRODUCTION CREDIT OR SELLING GOODS TO, OR PROVIDING SERVICES FOR FARMERS, OR ENGAGED IN OTHER SIMILAR ACTIVITIES OR IN BUYING AGRICULTURAL PRODUCTS FROM FARM PRODUCERS EXCEPT FARMER-OWNED AND CONTROLLED COOPERATIVES, CORPORATIONS, AND ASSOCIATIONS WHICH MEET THE CONDITIONS OF THE CAPPER-VOLSTEAD ACT SHALL DIRECTLY OR INDIRECTLY ENGAGE IN THIS STATE IN AGRICULTURE OR PRODUCTIONS OF AGRICULTURAL PRODUCTS, OR CONTROL, OR ATTEMPT TO CONTROL AGRICULTURAL PRODUCTION THROUGH THE OWNING, LEASING, OR HOLDING OR OTHERWISE CONTROLLING LAND FOR AGRICULTURAL PURPOSES OR BY CONTRACTS WITH OTHERS OR BY INTEGRATION, MERGER, OR ANY OTHER MEANS OF ACQUISITION OR CONTROL; PROVIDED THAT THE FOREGOING PROHIBITION SHALL NOT APPLY IN THE CASE OF ANY ONE OR MORE OF THE FOLLOWING:

(1) CHARITABLE INSTITUTIONS WHICH ENGAGE IN AGRICULTURAL PRODUCTION FOR OTHER THAN INCOME PURPOSES AS A PART OF THEIR CHARITABLE FUNCTION;

(2) EDUCATIONAL INSTITUTIONS WHICH ENGAGE IN RESEARCH AS A PART OF ACADEMIC AND EXTENSION ACTIVITIES;

(3) NONPROFIT INSTITUTIONS ENGAGED IN AGRICULTURAL PRODUCTION SOLELY FOR THE PURPOSES OF RESEARCH; AND

(4) GRAZING ASSOCIATIONS WHERE MEMBERSHIP IS COMPRISED

restrictions of the number and kinds of shareholders in farm corporations, the new bill seeks to limit vertical integration in the farm industry by completely prohibiting any form of business entity engaged in non-agricultural business from participating in the production of agricultural products. The central portion of the bill reads:

No person, partnership, corporation, trust, or conglomerate business entity engaged in nonagricultural business anywhere and owning or controlling assets amounting to more than three million dollars (\$3,000,000) or owning or controlling stock or other share of capital with a total value of one million dollars (\$1,000,000) or more in one or more business entities . . . shall directly or indirectly engage in this state in agriculture or productions of agricultural products, or control or attempt to control agricultural production. . . .⁶⁷

The bill specifies several "nonagricultural businesses," but does not limit its application to them alone. Some of the specified nonagricultural businesses include: businesses engaged in meat or poultry packing; businesses engaged in the wholesaling of meat, poultry, or livestock products; businesses engaged in processing, purchasing, and selling of

(5) ANY FEDERAL, STATE, COUNTY, OR CITY GOVERNMENT DEPARTMENT, AGENCY, OR BODY ENGAGED IN AGRICULTURAL PRODUCTION OR RESEARCH INCLUDING, BUT NOT LIMITED TO, POLITICAL SUBDIVISIONS, SPECIAL IMPROVEMENT DISTRICTS AND OTHER DISTRICTS AUTHORIZED BY LAW.

SECTION 5. NO FOREIGN CORPORATION AND NO DOMESTIC CORPORATION SUBJECT TO THE PROHIBITIONS OF SECTION 4, SHALL BE FORMED OR LICENSED UNDER THE MONTANA BUSINESS CORPORATION ACT.

SECTION 6. NOTHING IN ANY PROVISION OF THIS ACT SHALL BE CONSTRUED TO PREVENT ANY CREDITOR, LEGATEE, BENEFICIARY, OR INTERSTATE SUCCESSOR SUBJECT TO THE PROVISIONS OF THIS ACT FROM LAWFULLY ACQUIRING PURSUANT TO LEGAL PROCEEDINGS, AGRICULTURAL LAND OR OTHER MEANS OF AGRICULTURAL PRODUCTION OR OF CONTROL OF SUCH MEANS OF AGRICULTURAL PRODUCTION IF THEY SHALL DIVEST THEMSELVES OF SUCH PROPERTY WITHIN TWO (2) YEARS OF ACQUISITION; PROVIDED, HOWEVER, THAT FOR CAUSE SHOWN ADDITIONAL TIME MAY BE OBTAINED BY PETITIONING THE DISTRICT COURT OF THE COUNTY IN WHICH SUCH AGRICULTURAL LAND IS SITUATED.

SECTION 7. NOTHING IN THIS ACT PROHIBITS A PERSON, PARTNERSHIP, TRUNK (sic) OR CONGLOMERATE BUSINESS ENTITY FROM ENGAGING IN THE BUSINESS OF AGRICULTURE OR FROM OWNING, LEASING, HOLDING OR OTHERWISE CONTROLLING AGRICULTURAL LAND IN THIS STATE, ENGAGED IN THE BUSINESS OF AGRICULTURE WITHIN THE STATE PRIOR TO THE EFFECTIVE DATE OF THIS ACT; PROVIDED, HOWEVER, THAT NO SUCH PERSON, PARTNERSHIP, CORPORATION, ETC., SHALL ACQUIRE OR OTHERWISE CONTROL, DIRECTLY OR INDIRECTLY, ANY AGRICULTURAL LAND OR ENGAGE IN AGRICULTURE EXCEPT TO THE EXTENT WHICH HE HAD IMMEDIATELY PRIOR TO THE EFFECTIVE DATE HEREOF.

SECTION 8. THE ATTORNEY GENERAL SHALL HAVE APPROPRIATE AUTHORITY TO ENFORCE THE PROGRAMS OF THIS ACT.

SECTION 9. IF A PART OF THIS ACT IS INVALID, ALL VALID PARTS THAT ARE SEVERABLE FROM THE INVALID PART REMAIN IN EFFECT. IF A PART OF THIS ACT IS INVALID IN ONE OR MORE OF ITS APPLICATIONS, THE PART REMAINS IN EFFECT IN ALL VALID APPLICATIONS THAT ARE SEVERABLE FROM THE INVALID APPLICATION.

SECTION 10. THIS ACT IS EFFECTIVE ON ITS PASSAGE AND APPROVAL.

grain or other field crops; and, businesses engaged in the distribution of agricultural chemicals, farm supplies, or farm credit or insurance.⁶⁸ If a foreign or domestic corporation is in violation of the act, it cannot be licensed under the Montana Business Corporations Act.⁶⁹ The attorney general is charged with enforcement of the act,⁷⁰ although the act never specifies the penalties or sanctions to be used against noncomplying businesses or individuals.

(B) EFFECTIVENESS OF HOUSE BILL 132 IN PRESERVING THE FAMILY FARM

In the first part of this comment, three major factors for the decline of the family farm were listed. They were: (1) the industrialization of agricultural methods; (2) vertical integration; and, (3) federal tax advantages.⁷¹ Through an examination of how House Bill 132 deals or fails to deal with each one of these factors, the reader can reach a reasonable conclusion as to the bill's overall effectiveness in preserving the family farm.

House Bill 132 does very little to limit the increasing industrialization of agricultural methods. It neither prohibits research and development of newer and more efficient equipment nor does it contain any provision imposing taxes on large-scale equipment or prohibiting tractors of over 125 horsepower. Moreover, the bill contains no provision limiting the size of farms⁷² so as to make the use of large-scale equipment economically impractical. House Bill 132 has only a very indirect impact on the industrialization taking place in agriculture; it prohibits the vertical integration of firms manufacturing, selling, or distributing farm supplies including farm machinery with business entities directly engaged in agriculture. Obviously, this is no restriction on the continuing research and development of improved agricultural equipment but is merely a restraint on their integration with agricultural entities. Thus, industrialization of agricultural methods would continue unimpeded under House Bill 132.

Prohibiting vertical integration is the main goal of House Bill 132. As the policy segment of the bill points out:

Vertical integration of the agriculture industry by the processing, distributing, and retailing industries and conglomerate businesses has created situations of unfair, monopolistic competition for the family farmer. . . . It is state policy to restore competition to the agricultural industry and to provide for the continuance of the family farm.⁷³

To implement this policy the bill prohibits those engaging in "non-

⁶⁸*Id.*

⁶⁹Section 5 of House Bill 132, *supra* note 66.

⁷⁰Section 9 of House Bill 132, *supra* note 66.

⁷¹*See*, material *supra* note 41

⁷²Certain corporate restrictions do limit the size of farms; see material *supra* note 60.

⁷³Section 2 of House Bill 132, *supra* note 66.

agricultural business anywhere" from engaging in agriculture in Montana if they have interests within the financial restriction of the bill.⁷⁴ Thus, the bill goes beyond vertical integration in the field of agriculture alone. Such a mammoth prohibition surpasses any other state prohibition against vertical integration in the United States today.⁷⁵ The problem with this provision is not that it fails to deal with the problem of vertical integration effectively, but rather that the prohibition goes too far and becomes overinclusive. House Bill 132 could end up outlawing business interests that have no role in the vertical integration of the agriculture industry and that do not adversely affect the family farmer. Consider the following example. John Doe owns \$100,000 worth of stock in the XYZ corporation, a staple manufacturer located in Maine. He also controls stock worth \$900,000. John leases twenty acres of farmland in Montana and raises and sells carrots to local supermarkets. Under House Bill 132 John would be forced to liquidate his Montana holdings because he owned or controlled stock in a nonagricultural business and was directly engaged in agricultural production in Montana. The fact that his two holdings could not be vertically integrated and that he posed absolutely no threat to the family farmer (and in fact may have been one himself) will not place him within the bill's exceptions. Thus, House Bill 132 could easily overstep its intended goal and become overinclusive in the treatment of vertical integration.⁷⁶

The third factor in the decline of the family farm is the federal tax advantage that forces the family farmer to compete with people having large nonfarm incomes who can use their farms as a tax shelter. Although House Bill 132 was not intended to eradicate these tax shelters,⁷⁷ the bill could have that indirect effect. Since the bill prevents individuals or business entities who own or control assets of three million dollars or own or control stock of one million dollars in nonagricultural businesses in Montana,⁷⁸ a good share of the wealthy people using farming as a tax shelter could be prevented from doing so. Why? The person who ordinarily uses such a shelter has to be in a high income tax bracket so that the differential between that bracket and the tax on capital

⁷⁴The other requirements of section two are the owning assets of over three million dollars or owning or controlling stock or other share of capital with a total value of one million dollars.

⁷⁵Texas is the only other state limiting vertical integration in agriculture. Read the discussion of the Texas statute in the material *supra* note 60.

⁷⁶House Bill 132's restrictions could also raise some constitutional issues. Among some of the more prominent are: (1) House Bill 132 unconstitutionally discriminates against interstate commerce, (2) House Bill 132 violates the equal protection clause of the fourteenth amendment because it exempts certain farm cooperatives from the Act, (3) forcing a person or business entity to sell its property because he or it is engaged in agriculture could be taking property without due process of law in violation of the fourteenth amendment.

⁷⁷The statement of policy in section two of House Bill 132 indicates that the bill is chiefly aimed at ending vertical integration in agriculture.

⁷⁸Section 4 of House Bill 132, *supra* note 66.

gains may be profitable.⁷⁹ Thus, a person in a low bracket may not find such an investment profitable as his taxes could already be equal to or below the 25% capital gains provisions.⁸⁰ To produce an income that would fall in the 50-70% brackets, it seems logical to assume that people would have to have substantial investments, investments well within the minimums of three and one million dollars set up in the act. Therefore, although House Bill 132 may not have been intended to prevent the use of farming as a tax shelter, it could well have that effect.

CONSIDERATIONS TO REVIEW IN A POLICY FAVORING FAMILY FARMS

Throughout most of this comment, there has been an underlying assumption that the family farm is basically a worthwhile institution that should be maintained. As with most value judgments, this one is subject to some controversy. Thus, it seems logical to deliberate on some of the considerations involved in implementing such a policy.

Foremost in the minds of many of House Bill 132's supporters, such as the Farmer's Union,⁸¹ is the concept that Montana farmers must not be faced with competition from conglomerates and vertically integrated businesses. If these businesses are more efficient than the small family farmer, and if they contribute to an overall lessening in the cost of food production, why should they not be allowed to continue in business in these days of high food costs? Moreover, if Montanans truly believe in the free enterprise concept, as members of the Montana Farm Bureau contend,⁸² why should certain forms of business ownership be restricted? These questions lead to even more considerations. Assuming that larger farms are generally more efficient, would the cost of social disruption in rural life, the urbanizing and retraining of family farmers be worth the increased efficiency of an industrialized farm? Would the increased size of industrialized farms have potentially harmful effects on the rural environment? Is the fight against conglomerates and vertically integrated businesses a fight for the family farm or a play-off between competing economic forces? Finally, do we really have a family farm system now or has the family farm already disappeared? There are no easy answers for such questions. They all ultimately require a resort to individual values and personal feelings.

⁷⁹The use of this shelter is discussed more fully in the material *supra* notes 18-38.

⁸⁰INT. REV. CODE OF 1954, § 1231.

⁸¹As evidence of this attitude, read the statement of Farmer's Union official Clyde Jarvis in the Sunday Missoulian, May 27, 1973, at 22 col. 3.

⁸²The statement of Farm Bureau official Stanley Burger in the Sunday Missoulian, May 27, 1973, at 22 col. 2, indicates that the Farm Bureau opposes any restriction

CONCLUSION

Three factors in the decline of the family farm have been: (1) the industrialization of agricultural methods; (2) vertical integration; and, (3) federal tax advantages. In those states which have enacted "family farm" legislation, the legislatures have sought to restrict or eliminate corporate participation in agriculture as a means of preserving the family farm. House Bill 132, however, takes a different approach. It limits vertical integration in agriculture by nearly any kind of business entity or individual. Indirectly, the bill also limits some of the people who could use farming as a tax shelter. Although the bill attacks two of the factors contributing to the decline of the family farm, it fails to deal with the first: the industrialization of agricultural methods. As long as agriculture continues to industrialize and larger farms continue to be sought, fewer and fewer people will live on family farms. Thus, House Bill 132 alone will not save the family farm from extinction, although it could slow its demise. If the legislature decides that protection of the family farm is a worthwhile policy objective, legislation against the industrialization of agriculture will also be needed to preserve the family farm in Montana.