MINUTES OF THE SENATE COMMITTEE ON AGRICULTURE & SMALL BUSINE.

Held in Room 423-S, at the Statehouse at 10:00 a.m. a. m./p. m.,

on Thursday, January 29, 1981, 19__.

All members were present except:

The next meeting of the Committee will be held at 10:00 a.m. a. m./p. m.,

on Tuesday, February 3, 1981, 19__.

These minutes of the meeting held on Thursday, January 29, 1981, 19__ were considered, corrected and approved.

Fred A Kerr
Chairman

The conferees appearing before the Committee were:

Philip Ridenour, Lawyer--Cimarron, Kansas
Member of American Bar Assn. Ag Committee
Keith G. Meyer, Professor of Law, University of Kansas

Senator Kerr called the meeting to order. Senator Arasmith moved, Senator Thiessen seconded, that the minutes of the January 28, 1981 meeting be approved. Motion carried.

Copies of written testimony by Father John Stitz, Director-Catholic Rural Life, Archdiocese of Kansas City, Kansas, were distributed to committee members (copy attached to original minutes).

Senator Kerr introduced Philip Ridenour, an attorney from Cimarron, who distributed his brief survey and some suggestions regarding Kansas Farm Corporations, the advantages thereof, and some language that could possibly be incorporated in any legislation drafted. (Copy attached to original minutes) He has been practicing in Cimarron some nine years and has been involved in the formation of some 100 family farm corporations. He said there are income tax and estate tax benefits in incorporating a farm, as well as some non-tax benefits. He indicated many younger farmers are entering into farm corporations due to high machinery debts, etc. In answer to a question by Senator Karr, Ridenour stated non-farm income, such as a teacher's salary, cannot be put into the corporate income. Mr. Ridenour also answered that a town home should not be considered in a farm corporation, nor should cars be included. He feels a grandfather clause is needed in any future legislation to enable the farm corporations now legally existing to retain that status.

In answer to Senator Kerr's question as to what should be regulated, Mr. Ridenour stated he was opposed to large public corporations, investment firms representing large amounts of retirement funds, or alien owners buying farmlands in large amounts.

Mr. Ridenour pointed out real estate is often kept out of a farm corporation. Answering Senator Karr's question relative to drawing up a report form that is workable, Mr.Ridenour stated the present one works rather well.

Chairman Kerr called on Mr. Meyer who distributed a sheet pertaining to some issues raised by K.S.A. 17-5901 (see attachment to original minutes). This is self-explanatory. He, too, felt a grandfather clause should be included. If a new law is drafted it should be clear and specific, setting out stiff penalties which should be strictly enforced. He would be glad to work with the committee in whatever way he could.

Meeting adjourned.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

Senator Fred Kerr
Agriculture and Small Business Committee

From: John M. Stitz, Dir. Catholic Rural Life,
Archdiocese of Kansas City in Kansas

Re: Corporate Farm Bill

The Catholic Rural Life is firmly committed to the preservation of farmland, through the use, ownership and control of the family farmer. This principle is positively related to quantity and quality of the food supply and to the survival of rural towns and communities.

Therefore the question of corporate farm bill is of interest. Despite the drawbacks and limitations of the current law, at least it has partially fulfilled its purpose to deter the activity of corporations in the business of farmland ownership.

The law needs modernizing, perhaps Kansas needs a totally new law, one addressing the whole problem of land.

It would be important for new legislation to provide policy guidelines which will help Kansas agriculture in the following areas.

1. Retention of prime farmland under control of family farmers.
2. Aid to families who wish to incorporate.
3. Prohibit non-agriculture corporations, domestic or foreign in ownership of farmland.
4. Prohibit farm land from being used as a tax shelter
5. Classify farmland in some way and tax in a way that helps farmers.

In summary I am of the opinion that Kansas is now ready for a comprehensive farm land policy which will respect the interests of all citizens and interests. This policy would make sure that prime farmland stays in the hands of the people who live and work on the land. I do not think the "superfarm" concept of which USDA talks about should be allowed to take root in Kansas.

KANSAS FARM CORPORATIONS: A BRIEF SURVEY AND SOME SUGGESTIONS

Philip Ridenour
Ridenour And Knobbe
Lawyers
Cimarron, Kansas 67835

I. INTRODUCTION

This paper discusses some of the advantages, both tax and non-tax, of incorporating the family farm. Our experience with corporate farming in Southwest Kansas for the past ten years has been with family farms. We have not had any experience with any corporate farm which is other than a family farm.

II. INCOME TAX CONSIDERATIONS

A. Rate Differentials.

Saving income taxes is one of the major reasons for incorporating every family farm we have incorporated. The marginal tax rate differences between an incorporated and an unincorporated farmer show that the federal tax structure favors the incorporated farmer:

MARGINAL TAX RATES
CORPORATION AND INDIVIDUAL JOINT TAXPAYER

TAXABLE INCOME	CORPORATION	INDIVIDUAL
$ 10,000	17%	18%
15,000	17%	21%
20,000	17%	24%
25,000	17%	32%
30,000	20%	37%
40,000	20%	43%
50,000	20%	49%
75,000	30%	54%
100,000	40%	59%
150,000	46%	64%
200,000	46%	68%
250,000	46%	70%

Translating these rate differentials into actual dollars gives some idea of the yearly tax savings to be obtained by incorporating the family farm:

COMPARISON OF FEDERAL INCOME TAX BURDEN BETWEEN INCORPORATED AND UNINCORPORATED FARMS

ASSUME NET INCOME OF	$25,000	$50,000	$100,000
Salary to President	$10,000	12,000	25,000
Retained in Corporation	15,000	38,000	75,000
Tax to Individual	$ 1,062	$ 1,425	$ 4,633
Tax to Corporation	2,550	6,850	16,750
Total Taxes to Corporation and Individual	$ 3,612	$ 8,275	$ 21,750
Tax to Individual without Corporation	$ 4,633	$14,778	$ 41,998
Tax Savings of Incorporated Farm over Unincorporated Farm	$ 1,021	$ 6,503	$ 20,615

As these two tables illustrate the federal income tax laws encourage incorporation of the family farm. The tax savings available to the incorporated farmer can then be used to retire debt or improve the farm.

B. Fringe Benefits or "Perks."

The incorporated farmer enjoys several tax advantages purposely built into the federal tax structure which are available only to the corporate form of doing business:

1. Housing. The corporation may furnish housing to its employees, including shareholder-employees, and depreciate the dwelling. For example, this is what the Coors Corporation does with regard to the Coors houses in Golden, Colorado [Adolph Coors Co., 27 TCM 1351 (1968)]. The employee is not required to treat the value of the housing as income.

2. Medical Expenses. The corporation can pay and deduct the cost of medical and health insurance, and it can also deduct money paid to reimburse employees for medical expenses incurred. None of this is income to the employee.

3. Life Insurance. The corporation can pay and deduct premiums for the cost of up to $50,000 group term life insurance on the lives of each of its employees. Again, the premiums are not income to the employee. These provisions, medical and insurance, are found in many non-farm employee situations. Term

4. Retirement Plans. For high bracket taxpayers, a corporate profit sharing plan generally allows larger tax-deductible contributions than a self-employed retirement plan. As a practical matter, this is usually a primary reason doctors and dentists incorporate. However, we have not seen this in a farm setting. only!

III. ESTATE TAX CONSIDERATIONS

A. Simplified Gifts.

A customary means of reducing the size of a farmer's estate for federal estate taxes is to make gifts to children. Since real estate generally comprises the largest value, most farmers consider giving real estate instead of cash, machinery, or livestock. But a gift of real estate poses potentially serous problems:

1. Difficulty of description. (Metes and bounds if divided); peculiar fraction (i.e. 3/160 of NE 1/4 of 3-10-12) if undivided interest.

2. Loss of control, potential partition suit of undivided interest; sale or fencing if divided interest.

3. Loss of future income. Recipient is entitled to all future income.

4. "Paper" complications. Numerous deeds lengthen abstracts, increase confusion as to who owns what, and confuse local property tax authorities.

Conversely, if the farm is incorporated, a share of stock may rather easily be given without any of these problems:

1. Description is clear. "Ten shares of Acme Farm Corporation."

2. No loss of control. If Donor, after gift, owns 51 percent of voting stock of corporation, he is in total control of corporation, and no partition or sale of corporate assets can occur.

3. No loss of future income. Future income continues to be earned by and belong solely to corporation.

4. No "paper" complications. Transfer is only on books and records of corporation. No deed or recorded conveyances required.

Since it facilitates and simplifies gifts, a farm corporation at least indirectly assists estate planning.

B. <u>Installment Payment of Federal Estate Taxes</u>.

Section 6166 of the Internal Revenue Code permits the estates of farmers and other small businessmen to elect to pay federal estate taxes over a fifteen year period. The interest rate is 4 percent. Certain requirements must be met in order for the election to be made, one of which requires that the decedent must be carrying on an active trade or business at the date of his death.

Nearly every active farmer meets the "active trade or business" requirement; however, on the date the farmer retires and leases his real estate, on either a crop share or cash rent basis, he ceases to have an "active trade or business" and fails to qualify for the extended period to pay taxes. But by incorporating his farm the farmer can retire, draw social security, and still qualify for the extended period to pay estate taxes since the corporation continues to have an active trade or business.

IV. SELECTED NON-TAX BENEFITS OF FARM CORPORATIONS

A. Continuity.

Farm corporations are a method of continuing a family farm operation. Mortgages and lines of operating credit are relatively unaffected by the death of even a major shareholder.

Continuity of the family farm operation can perhaps be viewed with mixed emotions. Neighboring farmers anxious to add to land holdings will doubtless be irritated at the greater continuity of a farm corporation. But, the family whose farm operation may be salvaged and continued solely by virtue of the corporate form can be expected to favor farm corporations.

B. Maintenance of Unit.

We have formed some corporations solely in order to "lock" the farm operation together. Grandparents and parents who may have worked years to put together a continguous farm or simply one of sufficient size to support a family, as is often the case in a grazing operation, worry that it will be split up and fractured by their children or grandchildren. One way to prevent fracturing of the farm is to incorporate it.

Again, this aggregation of capital and maintenance of the farm as a unit will be regarded as disadvantageous by neighbors interested in acquiring additional real estate, but for those interested in seeing the family farm preserved and maintained as a unit, the corporate form offers some advantages.

V. CONCLUSIONS

From the foregoing, I believe the following conclusions can be drawn:

1. The graduated federal income tax and estate tax laws encourage incorporation of the family farm.
2. The incorporated family farm enjoys numerous tax advantages which reduce taxes and make it easier to pay off debt and transmit the farm to the next generation.
3. A farm corporation permits dollars that would otherwise go for taxes to the federal government to be used for the reduction of debt and for farm improvements, both of which strengthen the farm's financial condition, and farm corporations have therefore had a salutary and beneficial effect on Kansas agriculture.

VI. PROBLEMS WITH PRESENT LEGISLATION

Briefly, we see the following problems with present Kansas laws governing farm corporations:

1. The 5,000 acre limitation is artificially low for Western Kansas and for predominately grass operations.
2. It makes little apparent sense to carefully restrict farming of some crops but leave such crops as alfalfa and soy beans totally unrestricted.
3. The ten shareholder limitation hinders estate planning for a family corporation, and since it can be circumvented through the use of trusts (Opinion Letter of Vern Miller, July 14, 1972) it makes little sense.

In our opinion, the present restrictions are of little benefit and need to be revised or repealed and new legislation substituted.

VII. SUGGESTIONS

We have no idea what aspects of farm corporations the Kansas Legislature is attempting to regulate. The following draft of a statute restricting farm corporations is designed to permit the family farm corporations we represent in Western Kansas, as well as our colleges and churches which have been given real estate by gift or devise, to continue to own and operate real estate.

SECTION I. No corporation, limited partnership, or business trust shall either directly, indirectly, or for its benefit own, control, lease, rent, manage, or supervise more than 160 acres of real estate in this state unless it shall comply with one or more of the following exemptions:

1. A corporation having not more than ten shareholders, all of whom are natural persons resident of the state of Kansas, shall be exempt from all acreage limitations.
2. Any corporation meeting one or more of the exemptions of subparagraphs (a), (b), or (c) hereof shall be exempt from all acreage limitations.
   (a) An electing small business corporation (within the meaning of Section 1371(b) of the Internal Revenue Code);
   (b) A corporation of which at least 50 percent of the total combined voting power of all classes of stock entitled to vote, and at least 50 percent of the total number of shares of all other classes of stock of the corporation, are owned by members of the same family; or
   (c) Any corporation (and any predecessor corporation) which does not have gross receipts exceeding $250,000 in any twelve month period. For purposes of the preceding sentence, all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a) of the Internal Revenue Code shall be treated as one corporation.

3. Any corporation, foreign or domestic, which leases not less than 75 percent of the total real estate owned or controlled by it in this state to natural persons resident of this state shall be entitled to 640 acres.

4. A bona-fide non-profit charitable foundation, corporation, college, university, or church shall be entitled to 320 acres; PROVIDED HOWEVER, that real estate in this state acquired by gift or devise, shall not be counted or considered in determining the number of acres held by any qualifying organization.

SECTION II. MEMBERS OF THE SAME FAMILY. For purposes of SECTION I:

1. The members of the same family are an individual, such individual's brothers and sisters, and brothers and sisters of such individual's parents and grandparents, the ancestors and lineal descendants of any of the foregoing, a spouse of any of the foregoing, and the estate of any of the foregoing.

2. Stock owned, directly or indirectly, by or for a partnership or trust shall be treated as owned proportionately by its partners or beneficiaries; and

3. If 50 percent or more in value of the stock in a corporation (hereinafter in this paragraph referred to as "first corporation") is owned, directly or through paragraph 2, by or for members of the same family, such members shall be considered as owning each class of stock in a second corporation (or a wholly owned subsidiary of such second corporation) owned, directly or indirectly, by or for the first corporation,

in that proportion which the value of the stock in the first corporation which such members so own bears to the value of all the stock in the first corporation.

For purposes of paragraph 1, individuals related by the half blood or by legal adoption shall be treated as if they were related by the whole blood.

SECTION III. It is the express policy of the State of Kansas to limit ownership of real estate in this state by foreign and non-family owned corporations and corporations with over ten shareholders who are not all natural persons resident of the state of Kansas and the foregoing statute shall be liberally construed to favor such intent.

Some issues raised by K.S.A. 17-5901

Presented to the Senate Agriculture & Livestock Committee

Keith G. Meyer
Professor of Law
University of Kansas

I. Why have legislation like this?

A. Encourage family farm units? (What is a family farm unit toda
B. Keep large nonfarm oriented corporations out of farming?
C. Prohibit large operations?
D. Control farm land ownership?
E. Prevent absentee ownership?
F. There is no justification for the State to get involved.

II. Assuming that you want to control farming, how should it be done?

A. Directly control through legislation who can farm. Place specific and clear restrictions on individuals, partnerships (general and limited), corporations (profit and nonprofit), and other business entities such as trusts recognized under § 400 et. seq. I.R.C.
B. Indirect controls such as tax incentives.

III. What activities are to be controlled if it is done directly?

A. Ownership?
B. All farming related activities?
C. Only certain related farming activities such as grain farming?

IV. Suppose that you choose to restrict farming activities to family farm units. What exceptions would you want to make? Here are some areas you might consider:

A. Encumbrance taken for purposes of security.
B. Land owned for research or experimental purposes connected with seeds, animals, or plants for sale or resale to farmers or related purposes.
C. Agriculture land, including leasehold interests, owned or obtained by nonprofit corporations. (want to restrict to gifts
D. Land not to be used for farming or acquired immediate or potential nonfarming use.
E. The DuPont case facts.
F. Agriculture land acquired by financial institution by due process of law in the collection of debts. (Need to decide if the Bank can keep the land obtained this way or has to sell it within a certain period of time.)
G. A municipal corporation.
H. Grandfather clauses for existing uses such as would violate the new restrictions.

V. Penalty

VI. Reporting requirements

SENATE

AGRICULTURE AND SMALL BUSINESS COMMITTEE

DATE January 29, 1981 PLACE ROOM 423-S TIME 10:00 a.m.

GUEST LIST

NAME	ADDRESS	ORGANIZATION
John Blythe	Manhattan	KFB
Dave Grotthusen	Scott City	Scott Co
Lynda Ryan	Topeka	AAM
[illegible]	KCK	Kansas Catholic Conference
Dr. Wayne Zimmerman	Topeka	The Electric Co. Assoc
Del [illegible]	Topeka	KLA
Bruce [illegible]	Perry	KLA