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SOUTH DAKOTA REFERENDUM ON CORPORATE FARMING

— by Neil E. Harl*

On November 3, 1998, the voters in South Dakota approved an initiative on corporate farming and land ownership in the state.¹ The provision adds substantial limitations to the South Dakota limitation enacted in 1974.²

Statutory limitations

The 1974 South Dakota limitations on farm corporations³ were patterned after the Minnesota statute⁴ which served as a pattern for statutes in Missouri⁵ and Iowa⁶ as well as South Dakota. The South Dakota statute imposed a ban on corporate ownership of “real estate used in farming” and on corporations engaging in farming⁷ with numerous exceptions including exceptions for family farm corporations and authorized farm corporations.⁸ As enacted, the statute defined a “family farm corporation” as a corporation—

“...founded for the purpose of farming and the ownership of agricultural land in which the majority of the voting stock is held by the majority of the stockholders who are members of a family related to each other within the third degree of kindred, and at least one of whose stockholders is a person residing on or actively operating the farm, and none of whose stock-holders are corporations; provided that a family farm corporation shall not cease to qualify as such...by reason of any devise or bequest of shares of voting stock.”⁹

An authorized farm corporation was defined as a corporation with one class of stock held by not more than 10 shareholders, all of whom are natural persons or estates, and with not more than 20 percent of its gross receipts coming from rent, royalties, dividends, interest and annuities.¹⁰

In 1988, South Dakota voters approved an initiative prohibiting corporations, except family corporations, from owning or operating hog confinement facilities in the state.¹¹

The 1998 initiative

The 1998 initiative added language to the South Dakota Constitution¹² providing that neither corporations nor “syndicates” could acquire an interest in “real estate used for farming” in South Dakota or engage in farming.¹³ The term “syndicate” is defined in the provision to include any “limited partnership, limited liability partnership, business trust, or limited liability company.”¹⁴ The term “syndicate” does not include general partnerships “except general partnerships in which nonfamily farm syndicates or nonfamily farm corporations are partners.”¹⁵ The term “farming” was defined broadly to include “...the cultivation of land for the production of agricultural crops, fruit, or other horticultural products, or the ownership, keeping, or feeding of animals for the production of livestock or livestock products.”¹⁶

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The scope of the 1998 initiative, by including forms of organization other than the corporation, is considerably broader than the 1974 limitations.

Specific exceptions

The 1998 initiative contains several exceptions from the broad prohibitions in the provision.¹⁷

1. Under the first exception, “a family farm corporation or syndicate” is permitted to engage in farming and own agricultural land.¹⁸ To come within the exception as a “family farm corporation or syndicate,” which is a term not otherwise specifically defined in the provision, a majority of the “partnership interests, shares, stock or other ownership interests” must be held by members of a family “or a trust created for the benefit of a member of that family.”¹⁹ At least one of the family members in a family farm corporation or syndicate must reside on or be actively engaged in the “day-to-day labor and management of the farm.”²⁰ That requires “both daily or routine substantial physical exertion and administration.”²¹

2. The second exception refers to cooperatives (both in terms of agricultural land acquired or leased and in terms of livestock kept, fed or owned) if a majority of the ownership in the cooperative is held by “natural persons actively engaged in the day-to-day labor and management of a farm, or family farm corporations or syndicates” and who either acquire from the cooperative the livestock and crops produced on the land or deliver to the cooperative crops to be used in the keeping or feeding of livestock.²²

3. Non-profit corporations are excluded from the 1998 initiative.²³

4. Agricultural land which is owned, leased or “being farmed” as of November 3, 1998, by a corporation or syndicate is excepted.²⁴

5. Livestock owned by a corporation or syndicate as of November 3, 1998, is not subject to the initiative.²⁵ This exception does not extend beyond the term of any contract signed as of November 3, 1998.²⁶

6. Farms operated for research or experimental purposes are also exempt from the initiative's limitations.²⁷

7. Land leases “by alfalfa processors for the production of alfalfa” are not subject to the provision.²⁸

8. The initiative does not apply to mineral rights on agricultural land;²⁹ agricultural land used for growing seed, nursery plants or sod;³⁰ custom spraying, fertilizing or harvesting;³¹ and agricultural land “acquired or leased by a corporation or syndicate for immediate or potential nonfarming purposes, for a period of five years from the date of purchase;”³²

9. The initiative exempts bona fide encumbrances taken for purposes of security³³ and agricultural land or livestock acquired in the collection of debts or enforcement of liens (but lands so acquired must be disposed of within five years and livestock within six months).³⁴

10. The initiative does not extend to “livestock futures contracts, livestock purchased for slaughter within two weeks of the purchase date, or livestock purchased and resold within two weeks.”³⁵

11. The initiative does not apply to agricultural land held by a state or nationally chartered bank as trustee for a person, corporation or syndicate which is exempt from the provisions of the initiative.³⁶ A question is raised as to agricultural land held by an individual or individuals as trustee. The initiative does not include trusts in the definition of syndicate except for “business trusts.”³⁷ Trusts created for the benefit of family members are authorized to hold interests in a family farm corporation or syndicate.³⁸ But a trust owning agricultural land, for example, is not mentioned and would appear to be permissible under the 1998 initiative unless the arrangement constitutes a “business trust.”

Consequences of violating the limitations

If a corporation or syndicate violates any terms of the initiative, the state attorney general is to commence an action to enjoin “any pending illegal purchase of land or livestock” and is to force divestiture of land (within two years) or livestock (within six months).³⁹ Family farm corporations and syndicates ceasing to meet the criteria have up to 20 years to requalify, dissolve or “return to personal ownership.”⁴⁰

Annual reports are required of all corporations and syndicates owning agricultural land or engaging in farming.⁴¹

Implications for firms subject to the initiative

The 1998 initiative, as a constitutional provision, obviously takes precedence over the statutory limitations.⁴² With the veritable explosion in new forms of organization in recent years, including limited liability companies and limited liability partnerships, the constitutional provision will be difficult to change as new forms of organization are developed.

It is important to note that neither this provision nor any of the other state-level limitations apply to individual ownership or co-ownership of agricultural land or farming operations. Moreover, general partnerships are not limited by the provision so long as nonfamily farm syndicates or nonfamily farm corporations are not partners. To the extent that an economic incentive exists to carry on farming operations or own agricultural land in the state, individuals are expected to try to structure the arrangements to avoid conflict with the initiative.

The initiative is expected to result in some livestock ventures being located in states without such limitations.

FOOTNOTES

- 1 Amendment E to S.D. Const. Art. XVII, Secs. 21-24.
- 2 S.D. Cod. Laws §§ 47-9A-1, 47-9A-23. See generally 6 Harl, *Agricultural Law* § 51.04[2][e](1998); Harl, *Agricultural Law Manual* § 7.02[1][c] (1998).
- 3 S.D. Cod. Laws §§ 47-9A-1, 47-9A-23.
- 4 Minn. Stat. § 500.24.
- 5 Mo. Rev. Stat. Ch. 350.
- 6 Iowa Code Ch. 9H (1997).
- 7 S.D. Cod. Laws § 47-9A-3.
- 8 S.D. Cod. Laws § 47-9A-13.
- 9 S.D. Cod. Laws § 47-9A-14.
- 10 S.D. Cod. Laws § 47-9A-15.
- 11 S.D. Sess. Laws Ch. 371 (1988).
- 12 S.D. Const. Art. XVII, Secs. 21-24.
- 13 S.D. Const. Art. XVII, Sec. 21.
- 14 *Id.*
- 15 *Id.*

¹⁶ *Id.*
¹⁷ S.D. Const. Art. XVII, Sec. 22.
¹⁸ S.D. Const. Art. XVII, Sec. 22(1).
¹⁹ *Id.*
²⁰ *Id.*
²¹ *Id.*
²² S.D. Const. Art. XVII, Sec. 22(2).
²³ S.D. Const. Art. XVII, Sec. 22(3).
²⁴ S.D. Const. Art. XVII, Sec. 22(4).
²⁵ S.D. Const. Art. XVII, Sec. 22(5).
²⁶ *Id.*
²⁷ S.D. Const. Art. XVII, Sec. 22(6).
²⁸ S.D. Const. Art. XVII, Sec. 22(7).
²⁹ S.D. Const. Art. XVII, Sec. 22(9).

³⁰ S.D. Const. Art. XVII, Sec. 22(8).
³¹ S.D. Const. Art. XVII, Sec. 22(14).
³² S.D. Const. Art. XVII, Sec. 22(10).
³³ S.D. Const. Art. XVII, Sec. 22(13).
³⁴ S.D. Const. Art. XVII, Sec. 22(11).
³⁵ S.D. Const. Art. XVII, Sec. 22(15).
³⁶ S.D. Const. Art. XVII, Sec. 22(12).
³⁷ S.D. Const. Art. XVII, Sec. 21.
³⁸ S.D. Const. Art. XVII, Sec. 22(1).
³⁹ S.D. Const. Art. XVII, Sec. 24.
⁴⁰ S.D. Const. Art. XVII, Sec. 23.
⁴¹ S.D. Const. Art. XVII, Sec. 24.
⁴² See n. 2 *supra*.

Trouble in Iowa's Shared Appreciation Agreements

by George S. Eichorn*

Beginning in 1988, the FmHA (now FSA) started using Shared Appreciation Agreements (SAA) whenever a borrower had a write-down of debt.¹ Those agreements were written to "expire" in ten years. Now, we are just beginning to see the results of those agreements. There is very little legal precedent on those SAAs and they present complex legal issues. Farmers should be aware of mistakes and problems appearing.

The purpose of the SAA was for the FSA to recover more money from loan write-downs. The borrower and the FSA agreed to share any appreciation on an agreed upon number (defined in the SAA as the "market value securing the loan"). The "market value securing the loan" was supposed to be the value of the mortgaged land at the time of the agreement. FSA had the ground appraised before the SAA was executed. When the ten years was close to expiration, the ground was to be appraised again (including improvements). The borrower would then owe 50 percent of any appreciation on the ground, up to the amount of write down.

Some of Iowa's SAAs have caused particular concern. For some, the "market value securing the loan" was incorrectly computed. The FSA included other property in addition to the mortgaged land when computing the "market value securing the loan." The result was an inflated number being used for the "market value securing the loan" on the SAA. In those instances, the FSA and the SAA told the borrower they would share appreciation computed from a higher number than the appraised value of the land. After ten years, the borrower would share the difference between the new appraisal of the land and the inflated "market value securing the loan" instead of the difference between the new land appraisal and the old land appraisal. Of course that would mean less money to be repaid than if the FSA used a market value of only the mortgaged real estate.

Currently, the FSA is reviewing Iowa's SAAs and trying to rewrite the incorrectly drafted SAAs. The first step they take is to notify the borrower of the error and ask the borrower to execute an amendment. The amendment will generally mean the borrower will owe more money than they anticipated for the last nine years.

The FSA has been to the National Appeals Division twice on this issue. In the first instance, the borrower was without benefit of counsel and the FSA won. I am expecting a ruling on the second case in March.

There are other problems occurring around the country with SAAs. One problem is obtaining the money to pay for these agreements. There may be significant appreciation on the land value over the ten years, but there is no cash available to pay the debt. If the borrower desires FSA refinancing, the borrower must request it within 30 days of the notice requesting payment. FSA will refinance upon three conditions: (1) if the borrower is unable to borrow the money elsewhere, (2) if the borrower has other loans with the FSA, and (3) if the borrower can show the ability to repay the debt. Any refinancing will be on "non-program" terms. Those include higher interest rates and less (if any) loan servicing.

Another problem concerns the appraisal of the mortgaged property. Sometimes there is a disagreement over current value. In most instances, the borrower may challenge the appraisal. Normally that will require hiring an independent appraisal. The borrower must still demonstrate why the borrower's appraisal is more accurate than the FSA's appraisal.

Borrowers should be aware there are significant unresolved legal issues concerning these SAAs. It would be wise to review any SAA to start preparing for its expiration.

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Footnotes

¹ 7 U.S.C. § 2001. See 7 C.F.R. §§ 1951.909, 1951.910, 1951.914, Part 1951, Exhs. A, D.