The Farm-Ranch Corporation

A Tool for Financial Planning and Management

Deon W Hubbard
Grant E. Blanch

Station Bulletin 576
February 1961

Agricultural Experiment Station
Oregon State University
Corvallis

The Farm-Ranch Corporation

A Tool for Financial Planning and Management

Table of Contents

Pages

Introduction 3- 4

The corporate form of business ownership can be useful to farmers and ranchers as the size of their operation increases and financial planning and management become more complex.

The Corporation—A Management Tool 5- 9

Corporate organization separates, yet facilitates continuity and transfer of ownership, operation, and management of a farm or ranch. A business can be more easily maintained and operated as a perpetual economic unit.

How a Corporation is Taxed 10-15

A corporation is taxed as a separate entity unless, for federal income tax purposes, stockholders have made a "tax-option" election to be taxed as a partnership. Proper tax planning with corporate devices may facilitate the saving of income, estate, inheritance, and gift taxes.

Capitalization and Credit Structure 16-18

Capital structure may include one or several types of stock and debt instruments, depending upon objectives. However, a "tax-option" corporation can have only one class of stock. The corporation structure will often facilitate obtaining credit, although stockholders may be required to sign personally for corporation loans.

Insurance 19-20

Incorporating a farm or ranch will probably require changes in the insurance program of the business and its owners. Stockholders may be corporation employees and as such participate in various insurance and other fringe benefit programs.

Retirement Programs 21-22

The corporation can be a means of aiding retirement from the farm through social security assisted by other retirement, pension, or profit-sharing plans. The possibility of stock sales, redemption of debt securities, and the receipt of rents and interest can make farm retirement more secure.

Legal Requirements for Incorporating 23-25

Legal requirements for incorporation are basically simple and restrictions are not severe, although requirements are technical in nature and must be strictly adhered to. Additional records and reports need not be a serious deterrent to incorporation.

Cost of Incorporating 26-27

With proper planning, cost of incorporating and the continuing costs of incorporation need not be significant. This is particularly true if a corporation is structured to accomplish intended objectives.

Dissolving a Corporation 28

Dissolving a corporation is a formal legal procedure and may be voluntary, or it may be involuntary if certain formal requirements are not maintained.

Introduction

In the search for better methods of agricultural management, considerable attention has been turned to the corporation as a useful form of business organization. Certain farmers and ranchers can simplify their financial planning and management by using the corporate form. This is particularly so in "estate management," the accumulating, maintaining, and transferring to the next generation the "agricultural estate" with maximum production capacity and with minimum taxes, costs, and capital shrinkage.

Advantages and disadvantages exist in the corporate form of business organization.

Advantages

- Division of ownership is greatly simplified. A share of the whole farm-ranch unit is represented by readily divisible shares in the form of security certificates.
- Transfer of ownership is greatly simplified. Corporate securities can be bought, sold, traded, or given as gifts without legally disrupting or breaking up the farm business.
- Continuity of operation of the farm-ranch can be more easily assured, since a corporation's life can be perpetual. The corporation does not depend upon the life of a single individual.
- Limited liability protects individual or other business property of stockholders from claims of liability against the corporation. Likewise the corporation is protected from personal claims made upon the stockholders.
- Income taxes can be saved, in some cases, by incorporating, but these cases will be the exception rather than the rule for farm-ranch corporations. The corporation with its readily divisible and transferable certificates can make estate planning easier and possibly eliminate estate or inheritance taxes.
- Raising outside capital may be encouraged with the use of corporate securities, although raising capital in this manner is still quite limited for family farm-ranch corporations.
- Favorable tax treatment permits retirement and other "fringe benefit" programs to be developed by the business for stockholder-officers as employees.

Authors: Deon W Hubbard is a Graduate Research Assistant and Grant E. Blanch is an Agricultural Economist, Oregon Agricultural Experiment Station. Harry T. Allen, Attorney and Assistant Professor of Business Administration, Oregon State University, was consulted on legal phases of the manuscript.

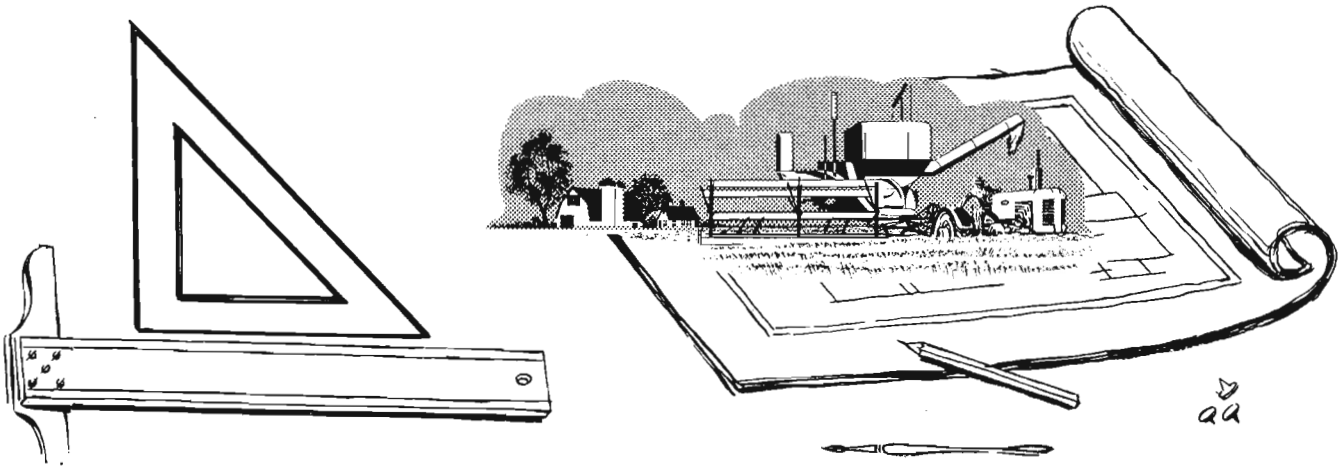
Disadvantages

- Serious income tax disadvantages can occur unless care is taken to prevent them.
- Incorporating means additional expense. Costs include lawyer and accountant fees as well as an incorporation fee and an annual license fee. A federal stamp tax is in effect on issuance and transfer of stock.
- A certain formality is necessary to incorporate, and additional record keeping and filing of reports is required.
- Taxes and other considerations may make dissolution of a corporation an involved and expensive procedure.

Farming and ranching today are in the throes of a technological upheaval unparalleled in history. Requirements for capital are increasing—funds to purchase land, buildings, livestock, and equipment and to meet operating expenses are in demand. Farms and ranches have become larger and land prices have increased, thus requiring larger investments in land. Investments in machinery and equipment also have risen as specialized and complicated machinery has been developed in the search for efficiency and economy in production. Labor-saving equipment has increased the optimum size of livestock and dairy herds, thus requiring more investment. In addition, the needs for fuel, chemicals for weed and insect control, fertilizers, repairs, maintenance and other operating needs have multiplied and prices have risen. All of these add up to larger and larger investments in our farms and ranches. This additional investment often must come from sources off the farm.

Inherent in the changes occurring in commercial agriculture are all manner of financial and legal complexities. Among these complexities are taxes at federal, state, and local levels—income taxes, property taxes, inheritance and gift taxes, to name but a few. Taxes have reached such proportions that tax considerations enter into almost every business decision. Personal and business liability protection becomes more important and insurance needs increase. Additional difficulties arise with property ownership and transfer and with all of the tax and legal complexities such as will arrangements, trusts, probates, death estates, and executors. Many of these problems come into existence or become more complex as the size of the farm or ranch increases.

Problems associated with business trends in farming and ranching, such as accumulating, maintaining, managing, and transferring capital, may require changes in the form of business organization in agriculture if satisfactory solutions are achieved. This is the basis of current interest in the corporate form of ownership for family farms and ranches.



The Corporation---A Management Tool

This bulletin introduces the corporate form of business organization as a "tool" in assisting certain persons in agriculture in the solution of some of the involved problems of financial management. This information should *not* be considered as all inclusive or as a substitute for professional legal, accounting, and tax advice. Each individual case is unique and requires the special attention of a tax consultant, an attorney or lawyer, who will apply specific laws, rules, and regulations to the individual owner's circumstances and personal desires.

The corporation itself is a relatively simple concept. When understood and used effectively, it can solve intricate financial problems.

The corporate form of business organization can be adapted to benefit certain farmers and ranchers in their financial planning and management, particularly in "estate management." It can assist in accumulating, maintaining, and transferring to the next generation the "agricultural estate" with maximum production capacity and with minimum taxes, costs, and capital shrinkage. Thus a farm or ranch may be maintained as a perpetual operating unit.

A Form of Ownership

There are three general types of business ownership—the single proprietorship, the partnership, and the corporation. The single proprietorship involves ownership of the business by one person. Two or more people own the partnership business in some joint manner. The corporation owns the business and owners of the corporation —called stockholders or shareholders—own a share of the whole business which is represented by stock certificates. The number of shareholders can vary from one to an unlimited number.

Nature of a Corporation

A legal person. In the eyes of the law, a corporation is an entity, an artificial legal being. It is created by law in the state in which the business is incorporated. A corporation as a legal entity has most rights of natural persons. That is, it can own property, buy, sell, trade, sue, be sued, borrow, make contracts, conduct business, pay taxes, and so forth. A corporation has no right to vote and unless engaged solely in interstate commerce, it cannot do business in another state without the authorization of that state. A corporation also differs from a natural person in that it can live forever (in most states) provided such registration and certain continuing requirements are met.

Separates owners and managers. Owners of the corporation, who are stockholders, elect a board of directors for the corporation. This board, representing stockholders, makes major policy decisions and appoints officers to manage the business within the framework of these adopted policies. For legal purposes, therefore, ownership and operation are separate, and assets and liabilities of the corporation are separate from assets and liabilities of the stockholders. In most farm-ranch corporations, however, officers also will be the board of directors and stockholders. Hence, for all practical purposes, ownership and operation are still one and the same, although there may be some additional division of ownership. Likewise, the outward appearance of a farm business that has been incorporated is not distinguishable from an unincorporated one.

Size not a prerequisite. Any legal business may be incorporated in Oregon and in most other states. Limitations to incorporation are not particularly restrictive and

requirements indicate that being a corporation is not restricted to the "big" company. The basic Oregon requirements can be satisfied by a "small company" as well. There need be only three individuals at least 21 years of age. Only $1,000, or property of that value, need be paid in for issuance of stock.

Other technical requirements will be discussed later in detail. These legal, technical requirements, though often troublesome, usually are not a major deterrent to incorporation. While corporations are generally thought of as being only big companies, a preliminary study shows this may not be true with incorporated farms and ranches in Oregon. Incorporating may have additional advantages for large farms or ranches, but this does not preclude possible advantages to small farm owners.

The corporation as it applies to agriculture is relatively new in importance. Farm corporations are few in number. Only about four-tenths of one percent of commercial farms and ranches in the United States are incorporated. In contrast, about 20 percent of all businesses other than farms are incorporated. Incorporation of farms has recently received considerable attention and the number of agricultural corporations seems to be on the increase. Approximately 350 farms and ranches in Oregon, representing about one percent of the commercial farms in the state, are currently incorporated.

When to Consider Incorporating

Corporate ownership may solve some of the following problems:

1. More than two persons are involved in the ownership of the farm-ranch business—for example, three brothers, or a father and his sons. Although there may be additional advantages in the corporation for multiple ownership, there are also advantages to be considered for the individual proprietorship.
2. The division of property is a problem—for example, parents wish to transfer the farm to more than one child or heir.
3. Splitting total farm income into additional tax paying units would put income into lower tax brackets.
4. Owners have considerable individual property in addition to the farm which they wish to protect from farm business liability.
5. Additional working capital is needed for farm operation.
6. The farm business is intended to exceed the life of any one of its present owners.
7. Business owners wish to obtain the tax advantages of fringe benefits as corporate employees, such as group life insurance, health and accident insurance, pension and profit sharing funds, workmen's compensation, and social security.

In any business with more than one owner it may be difficult to determine ownership of property and transfer rights. There are several kinds of joint property ownership arrangements such as joint tenants, tenants in common, or partnerships. These forms of ownership often are not precise as to what constitutes joint property or what constitutes an individual's private property.

A partnership might own no real property but use the individual property of its partners. Under the Uniform Partnership Act adopted by Oregon, a partnership may own property in its own name, in which case the individual partners have no claim to specific partnership property. Or the partnership may own some property and also have the use of the partner's or another individual's private property. In the case of a farm operated by a father and sons, who will own the farm real property? Will it be the father as tenant in common with his sons, or the father as tenant by the entirety with his wife? Will each own a separate acreage of the farm property? Will the partnership own any real property? Who will own the livestock, machinery, and supplies? What property will be owned by whom at the death of one of the owners? How can the financial interest of each person be protected?

Divisibility of Ownership

One important advantage of a corporation is its feature of divisible ownership. A farm-ranch business, in its entirety, may be owned by the corporation. This would include such things as land, buildings, equipment, livestock, supplies, grazing rights, and water rights. Ownership of the corporation would then be represented by shares of stock in the form of certificates which give evidence of ownership. These certificates can represent any number of shares or fractions of shares if desired. For example, if the corporation had issued one thousand shares of stock, four equal owners would each own 250 shares. These shares represent an equal interest in the entire business and not in a particular piece of property. Division of shares can thus be made easily, whereas equitable division of specific property can be difficult.

Certain people may not desire this sort of pooled ownership through a corporation. Many may wish to own specific property rather than a share of the whole. To meet this objection a lease or rental arrangement can be worked out permitting the corporate business to rent these specific properties from their owners.

The fact that stock represents shares of a whole business and not specific properties is one of the most important principles of a corporation. A corporate business theoretically can be divided among as many owners as there are shares of stock, and various arrangements and divisions of ownership are practically unlimited.

Transfer of Ownership

Any transfer of property, particularly real property, whether by sale, gift, or inheritance, has certain legal as well as personal implications. Equitable transfer may become especially involved if the property is going to more than one new owner. How to pass ownership of the family farm or ranch to the younger generation is a problem that confronts almost all farm owners at least once in their lifetime. Farm owners may have several heirs

to whom they wish to transfer their property either at their death or before.

These owners have several alternatives. They can make no preparation and at death let the property be transferred to heirs according to state inheritance law; they can make a will to transfer at death their property to whomever they choose; they can transfer their property before death by sale or gift or some combination of the two; they can combine parts of these alternatives. A strong desire usually exists to keep a farm in the family. Inheritance within a family is the principal way persons get into farming today when capital requirements are so high. Regardless of how transfer of property is made to the next generation, a problem arises in determination of what specific property is to be transferred and to whom if more than one heir is involved.

It is not generally desirable or economically practical today to divide the family farm into several units. Because of tax and other considerations, it may not be desirable to sell the farm and distribute cash. Interests vary and some members of the family may have contributed much more to the farm than others. For example, a son or sons may have remained on the farm and worked while other members of the family have worked off the farm or prepared for other professions. It may be economically desirable that the farm be owned by one or two persons, but cash may not be available to purchase the other heirs' property interest or to provide them with a cash inheritance. The problem is primarily the division of a farm-ranch unit which is not readily divisible. Here the corporation can be of service. Shares of stock can be bought, sold, traded, given as gifts, willed, or passed by law to heirs at death—all without legally dividing, breaking up, or disrupting farm business.

With these divisible units any combination of ownership transfer through gift, purchase, or inheritance can be devised to the benefit and advantage of all. A daughter and/or son living off the farm could share in ownership with a son living on the farm. The son on the farm may receive the majority of his income through salary as an officer of the farm-ranch corporation. After payment of expenses, including salaries to officers and possibly the setting aside of some funds in the business as reserves for contingency or expansion, remaining income could be distributed to stockholders in relation to the amount of stock owned. In this manner a son on the farm would share income with other owners in proper relationship to labor expended and share of business owned.

Continuity of Ownership and Management

Keeping the farm intact. The corporation does not dissolve with death or withdrawal of a major stockholder, director, or officer. Adjustments are needed, but in Oregon there must be at least three directors and two officers. Business can continue without disruption under the direction of remaining stockholders, directors, and officers.

A single proprietorship or partnership business is technically dissolved upon death or withdrawal of the proprietor or a partner. The business must be reorganized and may become disrupted or discontinued. This is also a problem with farms and ranches which usually represent the cumulative lifetime savings of sometimes more than one generation. At death of an owner, probates and uncertainties often disrupt the business. Heirs do not know where ownership lies or how the farm should be managed. Heirs are often unable or unwilling to make improvements, long range plans, or investments during a period of uncertainty. Productivity may decrease and deterioration of assets may result. Some of this difficulty can be eliminated by planning ahead even without a corporation, but the corporation offers considerable advantage for flexible planning.

Transfer—but maintain control. In a corporation continuity of ownership, operation, and management can be planned well in advance of any possible adverse situation, and plans can be amended as changes occur. Parents having lifetime savings in a farm can begin with greater ease a planned program to transfer to their children, over a period of years, ownership of the farm and responsibility of management. They need not "just let things work themselves out" or depend upon the law to make final distribution.

Transition of ownership and responsibility of management from one owner to another, from father to son, or sons, for example, can be a matter of strict business procedure. If stock is given or sold to them, the son or sons, as directors or officers of the corporation, may gradually assume management responsibilities even while the father maintains major interest and control. Ultimate control rests with 51 percent of the stock, although a stockholder can temporarily and under certain conditions grant his voting rights to another in a "voting trust agreement." Thus if desired, a father could virtually dispose of all his stock and yet maintain final control if he were entrusted with a simple majority of the voting rights. This stock disposal and voting trust arrangement may be particularly advantageous when the value of 51 percent of actual stock ownership would represent an estate too large to eliminate estate taxes or reduce them to a desired minimum.

Stock purchase and transfer agreements. With farm-ranch corporations likely to be closely-held or family corporations, it usually is desirable to form an agreement among stockholders to keep stock within the group. For this purpose stock purchase plans and transfer agreements can be devised for purchasing stock of a deceased or withdrawing stockholder.

In a closely-held or family corporation transfer or sale of stock outside the small group of existing stockholders may create problems. Outsiders may not have the same interests in the business as existing stockholders. They may demand changes in operations or officers, or may wish divided policy not concurrent with the desires of existing stockholders. Dissenting stockholders in a closely-held corporation can cause difficulty and hard feelings. A family may not wish to accept a stranger into their "family" corporation.

Problem situations of this nature often come about at the death of a major stockholder. Stock ordinarily

would pass to the estate of the deceased, subject to taxes and claims of creditors. If not sold by the administrator of the estate, the stock would probably pass to heirs. These heirs may continue to hold the stock, or they may sell it. In any case, old stockholders are faced with new stockholder partners. Old stockholders may not wish to accept new stockholders as "partners" and a new stockholder may not wish to get involved in a closely-held corporation. Problems exist on both sides. Thus it is often difficult to sell stock in a closely-held corporation at full value.

Often action to prevent this situation is taken in advance by using stock purchase agreements. These agreements basically provide that any stock to be sold will first be offered in some specified manner to existing stockholders or to the corporation. This agreement would be binding on the stockholder while he lives and on his estate at death. Surviving stockholders or the corporation might also be bound by agreement to purchase stock of the deceased stockholder. These agreements usually include a method for valuing stock to be bought and sold.

There are several advantages to these agreements: (1) Estate or heirs of a deceased stockholder can be assured of a market for this stock at a fair price. Otherwise there may be no market. (2) Surviving stockholders can be assured continuity of ownership and management by not having stock go to outsiders who could become disinterested or dissenting stockholders. (3) Establishment of a stock price for transfer agreement may assist in establishing an evaluation of the stock for estate tax purposes. Buy-sell agreements are often funded with life insurance on lives of major stockholders. Policies may be owned by the corporation or by other stockholders, depending on the purchase agreement.

Operation and Management

Management decisions must be made for farm-ranch corporations just as with any other type of ownership. However, corporate management usually involves more group management than an ordinary farm or ranch operation. In a corporation there are three distinct groups: stockholders, directors, and officers. Even though each group may consist of the same persons, certain rights and responsibilities exist in each position.

Stockholders. Stockholders do not participate directly in ordinary corporate management. Unless a stockholder has been given express authorization to act for the corporation, he cannot bind it to any contract or obligation. Business actions of stockholders must be transacted at regular or special meetings unless all stockholders consent to action outside such meetings. Stockholders may meet often but are required by law to meet once a year. Chief responsibility of stockholders is to elect directors. Stockholders indirectly control the corporation by their power to select directors who will carry out desired policies of the electing stockholders. If changes or amendments to articles of incorporation are desired, stockholders must approve these changes unless specific provision is granted to directors for such changes. Stockholders in their annual meeting will usually receive the corporation annual report.

Directors. Directors receive authority from the corporate charter or articles of incorporation. Directors represent and are entrusted with interests of stockholders who elect them. Directors of the corporation, under the guidance of a chairman elected by them, are charged with the responsibility of conducting the business. Directors establish a framework of management policy. They then elect or appoint a manager and other officers to execute management within limits of their established policy.

Directors act as agents of the corporation, and actions and policy decisions are done in the name of the corporation and not as individuals. Directors are not personally liable for authorized acts in managing the affairs of the corporation when they have exercised reasonable care.

Officers. Officers are employees of the corporation. Like directors they have a relationship of trust to it. Officers are elected or appointed by directors. They are responsible for the day-to-day operation and internal management of the business within a policy framework laid down by the directors. Officers may have broad or limited powers as determined by articles of incorporation, bylaws, or directors. Within these given powers their actions are binding upon the corporation. Like directors, they act as agents for the corporation. Officers like directors are not personally liable for authorized acts in managing the business when they have exercised reasonable care.

Limited Liability

For stockholders. A stockholder is not personally responsible for liabilities of the corporation. A stockholder's private property, such as home, securities, bank account, and other business property, even another farm or ranch, could not be attached to pay debts or settle a lawsuit of the corporation. A stockholder would not be personally liable for damages as the result of an accident involving an employee, vehicle, or farm animal if the accident occurred in connection with farm business and if the stockholder were not personally negligent. A stockholder with several separate business interests may wish to form several corporations in order to insulate the assets and liabilities of each business from the other and from his private property. For example, a farmer with a cattle feeding operation could keep this business separate from an orchard operation by incorporating one or both of these activities.

A stockholder must be aware, nevertheless, that a corporation loss or insolvency results in devaluation or complete loss of value of his stock. His losses will be restricted, however, to the value of his stock.

For corporations. A corporation as a legal entity is responsible for contracts and acts of liability done in its own name. Thus, it is responsible for its own debts or lawsuits independent of personal assets of its stockholders. The corporation is not responsible for personal acts or obligations of its stockholders or employees outside the scope of their employment. Thus the corporation cannot be forced to pay the personal debts of the stockholders. Where common law rules apply, the corporation also

cannot be held liable for a personal accident of a stockholder or employee unless negligence of the corporation or its agents can be proved. If the corporation has elected to be subject to Workmen's Compensation Law, it may be free from liability even if negligent. The claim in this case would be against the State Industrial Accident Commission. In a case of personal liability of a stockholder only his personal assets can be attached; the corporate assets are free from incumbrance.

Often almost all property will be held by the corporation, even the home and automobile used by the stockholder. In this case even these normally personal assets would be free from claims of personal liability against the stockholder. However, they would thus become subject to claims against the corporation, and the individual would lose certain exemption rights such as homestead exemption for Oregon inheritance tax. The stockholder must be aware that corporate stock is personal property and may be subject to claims of personal liability.

For proprietorships and partnerships. A single proprietorship or partnership does not have limited liability protection. Private property of a proprietor may be subject to claims on the business or vice versa. One partner may be personally liable for claims on a partnership resulting from action of another partner.

A little-used exception to this general partnership liability situation is the limited partnership. With the limited form of partnership one or more partners can have limited liability but they can have no active part in the business, and there must be at least one general partner who has unlimited liability. This kind of partnership has other limitations also, and like the corporation it must meet certain specific legal requirements and must register with the Corporation Commissioner in Oregon and file with the county clerk where the partnership does business.

Personal liability with corporate loans. Many banks and other lending institutions not only require the corporate "signature" on loans but also the personal signature of the major stockholders, making them personally liable for the debts of the corporation. In some cases stockholders may have to pledge or assign their stock to secure a loan. Of course, a stockholder is not legally obligated to personally sign for a contractual obligation of the corporation. The lender is often in the bargaining position and the stockholder's refusal to sign might mean the loan would not be granted to the corporation.

How a Corporation Is Taxed

The effects of taxation[1] are so important that no business decision should be made without carefully considering its many aspects. Business decisions should not be made solely on the basis of tax implications. With the farm-ranch business, taxation probably will not be the most important factor in considering incorporation, although it should be studied thoroughly.

Tax laws generally have been disadvantageous to the small farm-ranch corporation. However, a 1958 revision in the Internal Revenue Code removed significant tax differences between certain incorporated farm-ranch businesses and those not incorporated. Statements concerning taxation are difficult to make because laws are complex and problems are intricate. It is necessary, however, to state some general principles.

Double Taxation

A corporation is subject to federal income taxes the same as an individual but at different rates. Determination of taxable income for a corporation is basically the same as for the nonincorporated business. Incomes and expenses are treated essentially the same. Primary difference is in distribution of income and payment of tax. In an individual proprietorship taxes are paid as an individual on any taxable income earned by the business. Partners pay tax as individuals on their share of the partnership business income. The corporation pays tax on its income as a business independent of its stockholders' income. Then the profits of the business, if distributed as dividends to stockholders, are added to the stockholder's personal income and subject to taxation again. This results in double taxation on dividends above a $50 exemption for each taxpayer and a 4 percent dividend received credit. Eighty-five cents out of every dollar of dividends one corporation receives from another domestic corporation are excluded from taxable income. This is because the corporation paying the dividends has paid income tax once, and these dividends will be taxed again when distributed a second time to the ultimate stockholder. Small corporations have largely overcome double taxation by paying out earnings in form of salaries, interest, or rent to officers who are also usually stockholders.

If business income varies widely from year to year, it may be difficult to establish salaries which are reasonable and fairly constant in order to eliminate taxable income to the corporation. Reasonable salaries, commensurate with services rendered to the business, are deductible as business expense. The Internal Revenue Service generally has not been willing to accept salaries, however, which they considered unreasonable, equal to 100 percent of earnings, or which were in direct proportion to stockholdings.

The emphasis on salaries instead of dividends to distribute income eliminates the double tax. It likewise eliminates one of the flexible advantages of the corporation—the advantage of separation of income to owners on the basis of shares owned and income to officers or employees on the basis of services performed. Table 1 illustrates current taxes under certain conditions.

Tax Rates

Federal corporate tax rates for ordinary taxable income are currently 30 percent on the first $25,000 and increase to 52 percent on all taxable income above $25,000. Individual rates for married taxpayers are 20 percent up to $4,000 and do not exceed 30 percent until taxable income exceeds $16,000. A married couple with dependents or deductions would pay less tax than a corporation on ordinary income up to about $25,000. The advantage to the unincorporated taxpayer may be even greater because if corporation income is distributed to stockholders

[1] All tax illustrations use 1960 rates and regulations.

TABLE 1. Illustration of Federal Income Tax Rates[1]

	"Regular" corporation pays salaries but no dividends		"Regular" corporation pays salaries and all earnings as dividends		"Tax-option" corporation; partnership; or regular corporation which pays all earnings in salaries	
Business earnings $12,000	Salaries and corporate income subject to tax	Computed tax	Salaries with dividends added and corporate income subject to tax[2]	Computed tax[3]	Shares of income subject to tax	
Father	$ 5,000	$ 660	$ 6,000	$ 788	$ 6,000	$ 844
Son	5,000	660	6,000	788	6,000	844
Corporation	2,000[4]	600	2,000	600	-0-	-0-
Total Tax		1,920		2,176		1,688
Business earnings $25,000						
Father	$10,000	$ 1,636	$12,500	$ 2,156	$12,500	$ 2,278
Son	10,000	1,636	12,500	2,156	12,500	2,278
Corporation	5,000[4]	1,500	5,000	1,500	-0-	-0-
Total Tax		4,772		5,812		4,556
Business earnings $50,000						
Father	$20,000	$ 4,532	$25,000	$ 6,110	$25,000	$ 6,344
Son	20,000	4,532	25,000	6,110	25,000	6,344
Corporation	10,000[4]	3,000	10,000	3,000	-0-	-0-
Total Tax		$12,064		$15,220		$12,688

[1] According to 1960 rates under various business conditions and incomes—the father and son are both married, have no dependents, and are less than 65 years old; each takes optional standard deductions; each owns equal shares of stock or of the partnership.
[2] Includes dividends received from corporation and represents double tax.
[3] Tax computed to account for dividend exclusion and dividends received credit.
[4] This amount minus the tax may be taxed again as capital gains if and when received at the sale of stock because of its increased value.

as dividends, it will be taxed again. Usually, however, a combination plan will exist and earnings will be paid out as salaries until the individual taxpayer's rate exceeds the corporation tax rate. When this point has been reached it is advantageous for the corporation rather than the individual to pay the tax.

Earnings remaining after a corporation has paid its taxes are often used for debt reduction or held for additional working capital or for expansion. Retained earnings are not double taxed unless distributed as dividends. When earnings are retained, each share of stock becomes more valuable. Whenever stock is sold, increase in value is taxed to the individual as a long-term capital gain. This also represents double taxation on amount of earnings retained, but the tax applies to only one-half of the net gain and may be at a lower rate than the previous tax would have been.

Capital Gains

The farm-ranch corporation has been at a disadvantage in regard to long-term capital gains taxes which are usually taxed at a lower rate than ordinary income.

Some farm-ranch income often comes from what is termed "section 1231 transactions." This section of the Internal Revenue Code provides special treatment for gains and losses from sale or exchange of depreciable or real property used in trade or business if held for more than 6 months or, in the case of livestock, held for 12 months or more. This applies to such depreciable property as machinery and equipment or dairy, breeding, or work animals. If the sale price of these assets exceeds the depreciated value and has been held for the required period of time, gains are treated as long-term capital gains. If losses exceed gain they become ordinary losses. Gains on such transactions are taxable as long-term capital gains to the corporation at an alternative tax rate of 25 percent. The exception is that any excess of net long-term capital gains over the corporation's taxable income will be taxed as ordinary income.

An individual taxpayer making "section 1231 transactions" computes taxes differently and may pay a different tax than a corporation. An individual taxpayer with taxable income of $18,000 or less and filing a separate return, or a married taxpayer with taxable income of $36,000 or less and filing a joint return would add one-half the net gain to his ordinary income and pay a tax depending on his individual tax bracket. If taxable income exceeds $18,000 or $36,000 in the above cases, an alternative tax applies. This makes the effective tax rate 25 percent, the same as the alternative tax which applies to corporations. This means that long-term capital gains and "section 1231 gains," which are treated as capital gains, will not be taxed at a rate exceeding 25 percent. The effective capital gains tax rate will be less than the alternative tax rate for any individual in a tax bracket less than 50 percent.

Suppose 10 brood or dairy cows have been fully depreciated, have been held 12 months, and are to be

culled from the herd. They are sold for $1,000 above salvage value. A corporation having taxable income would pay 25 percent tax or $250. An individual farmer not subject to the alternative tax would include as income to himself only half the net gain or $500 and pay tax according to his individual tax bracket. Any individual farmer or stockman in less than a 50 percent tax bracket would have a tax advantage over the corporation. An individual taxpayer in a 26 percent bracket, for example, would pay $130 tax compared to the corporation's $250. An individual taxpayer to whom the alternative tax applied would pay $250—the same as the corporation. See Table 2 for additional illustrations.

"Tax-option" Corporations

Several important changes were made in the federal income tax law by the Technical Amendments Act of 1958. These changes can affect advantageously the taxation of most farm-ranch corporations. Section 64 of this act is known as Subchapter S—Election of Certain Small Business Corporations as to Taxable Status. This law provides that stockholders of a "small business corporation" can elect to have the corporation taxed as a partnership rather than as a "regular corporation." This "small business corporation" is also known by the names of "tax-option corporation," "subchapter S corporation," or "pseudo-corporation." The federal corporation tax does not apply and taxes on the income of the corporation are paid by the individual stockholders on the basis of shares of stock owned. This is on net taxable income regardless of whether income has been paid out to stockholders or retained in the corporation. This is like a partnership, which pays no tax and all income for tax purposes is passed to partners who pay at a rate in accordance with their individual tax bracket.

Capital gains and losses. Capital gains and losses in a "tax-option" corporation are carried through to individual stockholders. Individual exclusions and tax rates apply as if the stockholder were filing a tax return as an ordinary individual. One-half of the stockholder's share of the long-term capital gains is added to his other income and taxed according to his individual tax bracket. The capital gains illustration given earlier would apply here. This is an important consideration that is not applicable to the "regular" corporation. There is one limitation, however. These gains cannot be treated as long-term capital gains beyond a point where they exceed the corporation's taxable income. Thereafter they are taxed as ordinary income.

TABLE 2. Illustration of Federal Capital Gains Tax[1]

	Regular corporation pays tax on capital gains at rate of 25% regardless of income		Proprietorship pays tax on ½ capital gains according to taxpayer's tax bracket[2]			"Tax-option" corporation or partnership (two equal stockholders or partners) pay tax on ½ capital gain according to taxpayer's tax bracket[2]		
$12,000 business income plus $1,000 capital gains	Capital gains income subject to tax	Computed capital gains tax	Capital gains income subject to tax and effective rate	*Percent*	Computed capital gains tax	Capital gains income subject to tax and effective rate	*Percent*	Computed capital gains tax
Father			$500	26	$130	$250	22	$ 55
Son						250		55
Corporation	$1,000	$250						
Total		$250			$130			$110
$25,000 business income plus $1,000 capital gains								
Father			$500					
Son				38	$190	$250	26	$ 65
Corporation	$1,000	$250				250		65
Total		$250			$190			$130
$50,000 business income plus $1,000 capital gains								
Father			$500	50[3]	$250	$250	38	$ 95
Son						250		95
Corporation	$1,000	$250						
Total		$250			$250			$190

[1] If capital gain was $1,000 under various business conditions and incomes, 1960 tax rates—capital gains tax in this illustration is in addition to the tax on ordinary income illustrated in Table 1—the father and son are both married, have no dependents, and are less than 65 years old; each takes optional standard deductions; each owns equal shares of stock or of the partnership.

[2] Until alternative tax applies and the maximum tax becomes 25 percent of total capital gains.

[3] Alternative tax rate applies.

Operating losses. Any operating losses can also be carried through to the individual stockholder and applied to offset the stockholder's other income. This too is a provision not allowed a "regular" corporation.

Double tax eliminated. Double taxation can thus be eliminated with the "tax-option" corporation. Corporation income can now be distributed according to stock ownership without first paying a corporate income tax on it. An individual can treat income as dividend income, although no dividend exclusion or credit is allowed the individual on this dispersement of corporate income. If these earnings are needed in the corporation for working capital or expansion, they remain in the corporation without being subject to corporation tax. Income is distributed "on paper" to stockholders who include it in their taxable income even though they do not receive it at the time. These funds retained in the corporation after taxes have been paid can later be distributed to the stockholders without further tax.

Qualifications for a "tax-option" corporation. The Internal Revenue Code defines a "small business corporation" as a domestic corporation which is not a member of an affiliated group and which does not—

(1) have more than 10 shareholders
(2) have as a shareholder a person (other than an estate) who is not an individual
(3) have a nonresident alien as a shareholder
(4) have more than one class of stock
(5) receive more than 80 percent of the corporation income from outside the United States
(6) receive more than 20 percent of its gross receipts from rents, royalties, dividends, interest, annuities, or gains on sale or exchanges of stock or securities.

There is no limitation on "size" of the corporation other than number of stockholders.

As the law is stated, a voting trust would probably disqualify a corporation under rule (2) above.

All stockholders must consent to be taxed as a "tax-option" corporation. This election must be filed with the Internal Revenue Service within the last month preceding, or first month of a taxable year. A special form is available from the Internal Revenue Service. Any new stockholder must consent to the election and the notification filed with the Internal Revenue Service.

There are other more technical provisions of this "tax-option" law. Specific situations of each taxpayer vary, therefore it is necessary to obtain professional tax advice before making a decision concerning this election.

Oregon Corporation Excise Tax

Oregon, in its 1959 Legislature, did not adopt a provision for "tax-option" corporations. Therefore, even though a corporation elects to be taxed as a partnership for federal tax purposes, it cannot do so in the case of the Oregon excise tax. This will complicate a corporation's tax planning because tax planning for a "tax-option" corporation may be quite different from tax planning for a "regular" corporation.

Oregon corporation (excise and income) tax rates which would apply to agriculture are 6 percent. Because federal tax rates are much higher, a corporation will probably put more emphasis on tax planning for federal than for state tax.

Federal personal income tax rates are also much higher than Oregon personal income tax rates. However, the federal government gives some relief for certain kinds of income. Special allowances are made for long-term capital gains income and there are certain exclusions and credits for dividends received. The state of Oregon makes no such concessions. It does not recognize capital gains or dividend income as being different from regular income. These factors will limit effective use of the corporation and its special devices for tax saving so far as Oregon tax is concerned. In all tax planning it must be remembered that both federal and state laws are subject to change.

Estate and Inheritance Tax

Type of business ownership, whether proprietorship, partnership, or corporation, will not affect amount of death or gift taxes paid. Property, whether owned directly or represented by corporate securities, theoretically will be valued and taxed at the same rates. Use of corporate securities does facilitate flexible estate planning and particularly the making of gifts.

There are two methods of taxing property that passes from one owner to another at death. The federal government levies an estate tax. This is a graduated tax on total property of the deceased regardless of who receives the property. Oregon levies an estate tax and an inheritance tax. These are both graduated taxes. Estate tax is upon the total property in the estate of the deceased. Inheritance tax is an additional tax on the proportion of the property received by each heir and depending on the relationship of the recipient to the deceased.

Federal estate. This tax is on all property owned by the deceased at death including (1) property which has been given away while retaining an interest or control, and (2) any gifts made within three years of death if made in contemplation of death. Certain deductions are allowed from the gross estate. These include payment of debts, expenses of the estate, charitable contributions, and a marital deduction of 50 percent of the adjusted gross estate if the surviving spouse actually has the power of appointment or power to will that portion of the property qualifying as a marital deduction. After all deductions, the first $60,000 is exempt from taxation and can be passed tax free. With the marital deduction or in community property states, both husband and wife are allowed $60,000. Therefore, an estate of $120,000 would be tax free upon the death of one spouse. The estate tax rates are graduated and apply to the taxable estate after deductions and exemptions.

Federal estate tax rates continue up to a maximum of 77 percent in the top bracket (Table 3).

TABLE 3. Federal Estate Tax Rates (Partial Table)

Amount above exemption	Tax rate per each bracket
	Percent
$ 0 to 5,000	3
5,000 to 10,000	7
10,000 to 20,000	11
20,000 to 30,000	14
30,000 to 40,000	18
40,000 to 50,000	22
50,000 to 60,000	25
60,000 to 100,000	28
100,000 to 250,000	30
250,000 to 500,000	32

Oregon estate. Oregon's estate tax is levied on all property of the deceased including gifts given in contemplation of death except to charitable institutions. Oregon law allows no marital deduction as does federal estate tax law. Administration expenses of the estate and debts of the deceased or his estate are deductible. Due taxes including federal and Oregon gift taxes are deductible but federal estate taxes are not deductible. For those who qualify there is also a homestead deduction. The first $15,000 of taxable estate is exempt from taxation and the rates on the remainder of the estate progress for each bracket (Table 4).

TABLE 4. Oregon Estate Tax

Amount of taxable estate	Tax rate per each bracket
	Percent
$ 15,000 to 25,000	1
25,000 to 50,000	1½
50,000 to 75,000	2
75,000 to 100,000	3
100,000 to 300,000	5
300,000 to 500,000	7
500,000 to	10

Oregon inheritance. Oregon inheritance tax depends upon the relationship of the deceased to the receiver. When the recipient of an inheritance is grandparent, parent, spouse, child, stepchild, or any lineal descendant, the inheritance tax is considered paid by full payment of the estate tax. When the relationship is one of brother, sister, uncle, aunt, niece, nephew, or any lineal descendant of the same or son-in-law or daughter-in-law an inheritance tax is payable. Rates are progressive and the tax is additive from bracket to bracket. Rates apply to inheritance of each individual separately and not collectively. The first $1,000 is exempt from tax. Inheritance tax in Table 5 is in addition to the estate tax in Table 4.

For all other recipients the first $500 is exempt. The inheritance tax in Table 6 applies in addition to the estate tax in Table 4.

Creation of a corporation will not reduce death taxes. These taxes can be reduced only by reducing the estate size. This can be done effectively by using the corporation and its devices to actually transfer and divide ownership if the intent of the parties coincides with tax savings. Corporate securities are used for this and transfer can be made without physically cutting up or disrupting an estate. This is particularly important if the estate is composed of a farm, ranch, or other operating business.

TABLE 5. Oregon Inheritance Tax Rates—Brother, Sister, Uncle, Aunt, Niece, Nephew, or Any Lineal Descendant of the Same, Son-in-law, Daughter-in-law

Amount of inheritance	Tax rate per each bracket
	Percent
$ 1,000 to 3,000	1
3,000 to 5,000	2
5,000 to 10,000	4
10,000 to 30,000	7
30,000 to 50,000	10
50,000 to	15

TABLE 6. Oregon Inheritance Tax—All Others

Amount of inheritance	Tax rate per each bracket
	Percent
$ 500 to 1,000	4
1,000 to 2,000	6
2,000 to 4,000	8
4,000 to 10,000	10
10,000 to 25,000	15
25,000 to	20

Gift Taxes

One method of reducing taxable estate and reducing estate taxes is to make living gifts. After exemptions these gifts are also taxable, although federal gift tax rates are about three-fourths of the estate tax rates. With a few years of careful planning and use of gifts, most estates can be reduced to where there is little or no estate or inheritance tax to pay. Gifts are made irrevocable and the donor can never enjoy income from the gift. A gift with "strings attached" will generally not be acceptable for tax purposes and will be considered as remaining in the donor's estate. Because of these limitations and restrictions upon gifts, special care should be taken if gifts are made to minors.

Federal. Each individual has a lifetime gift exemption of $30,000. This means that married persons have a combined exemption of $60,000. The gift can be split for tax purposes, one-half to each person regardless of which one actually owned the property. In addition to this major exemption, which can be given all at once or over a period of years, each individual is entitled to a $3,000 annual exclusion to each of any number of beneficiaries. For example, a husband and wife together could give annually $6,000 to each of their children. If the parents desired and joined in doing so, it would be possible to give a married son or daughter and his or her spouse together $12,000 tax free each year. With gifts of this magnitude it does not require many years to reduce a sizeable estate to the tax free limits of estate tax laws.

Gifts that are given within three years of death are considered by the Internal Revenue Service as given in

contemplation of death. These gifts may not then be considered tax free as they become part of the estate subject to taxation. The burden is upon the estate to prove the gift was not made in contemplation of death. This could also apply to gifts on which the gift tax was paid. However, a credit against the estate tax will be allowed for any gift tax paid. Federal gift tax rates are given in Table 7.

TABLE 7. Federal Gift Tax Rates (Partial Table)

Amount of taxable estate (after deductions and exemptions)	Tax rate per each bracket
	Percent
$ 0 to 5,000	2¼
5,000 to 10,000	5¼
10,000 to 20,000	8¼
20,000 to 30,000	10½
30,000 to 40,000	13½
40,000 to 50,000	16½
50,000 to 60,000	18¾
60,000 to 100,000	21

These gift tax rates progress to 26¼ percent on amounts to $750,000 and on up to a top bracket of 57¾ percent. Gifts subject to tax are additive for tax purposes extending over the full period during which gifts are made. It can be seen by comparison that federal gift tax rates are less than the comparable federal estate tax rates. But the gift tax on a transfer may not always be less than the estate tax would have been. Because these tax rates are progressive and gift tax rates apply to the accumulated gifts, sometimes transfers of property may be taxed at a higher rate as gifts than if left and taxed as a part of the estate. But if the estate is large it will usually be desirable to make some living gifts and pay the necessary gift tax rather than allow all of the inheritance to be taxed at death in the estate at estate tax rates.

Oregon.[1] Oregon gift taxes are levied according to the same classes as explained under Oregon inheritance taxes. There is an overall specific exemption of $15,000 and an annual exclusion according to class: class I, (grandparent, parent, spouse, child) $5,000; class II, (brother, sister, uncle, aunt) $3,000; class III, (all others) $1,000. The marital deduction does not apply in Oregon; therefore, these exclusions and rates apply only to the individual who makes the gift, and they cannot be split between husband and wife as is the case for federal gift taxes. Gifts are additive for rate purposes. Certain charitable gifts are excludable from the state gift tax. The class I rate applies to all gifts regardless of class. If the gift is to a class II or class III beneficiary, the appropriate class rate applies *in addition to* the basic class I rate. For example, a gift of $500 in excess of the class exemption is made to a class III receiver. The combined gift tax rate applicable to this situation is 5 percent: class I rate of 1 percent plus class III rate of 4 percent.

Rates after exemptions are according to class (Table 8).

TABLE 8. Oregon Gift Tax Rates by Class

Amount of gift (after exclusions)	Class I	Class II	Class III
	Percent	*Percent*	*Percent*
$ 0 to 1,000	1	1	4
1,000 to 2,000	1	1	6
2,000 to 3,000	1	1	8
3,000 to 4,000	1	2	8
4,000 to 5,000	1	2	10
5,000 to 10,000	1	4	10
10,000 to 25,000	1	7	15
25,000 to 30,000	1½	7	20
30,000 to 50,000	1½	10	20
50,000 to 75,000	2	15	20
75,000 to 100,000	3	15	20
100,000 to 300,000	5	15	20
300,000 to 500,000	7	15	20
500,000 to	10	15	20

Tax savings may be accomplished in making property transfers if both gifts and inheritance are used in combination rather than making the transfer subject to gift taxes only or to estate and inheritance taxes only. Exemptions from gift, estate and inheritance taxes have been explained. At least the amount of these exemptions should be utilized (if tax saving is the objective). Because of these exemptions and the progressivity of these taxes, removal or withholding of taxable property from the upper tax brackets of one category and placing it in or keeping it in the lower tax brackets of another category may mean tax saving.

The corporation is not a device to eliminate or generally reduce gift taxes. But the use of corporate securities can greatly facilitate making gifts. Securities gifts do not give away specific physical assets of the estate, but a share of the whole. Stock certificates, notes, and bonds can be made in denominations to equal $3,000 to coincide with the annual gift exemption. However, remember that stock values vary and stock gifts are valued at the market at the time of the gift. Therefore, from time to time as stock gifts are made it may be necessary to vary number of shares given or in some instances pay a gift tax on amounts over the $3,000 exclusion.

[1] Oregon Revised Statutes, Chapter 119, Gift Tax.

Capitalization and Credit Structure

Capital structure—ownership and debt—of a corporation largely will be the result of how the corporation was established. A corporation may come about as an entirely new venture through sale of stock or stock and bonds. If sale of securities to outsiders is contemplated, type of stocks or bonds and interest rates will depend on market conditions. However, most farm-ranch corporations will come about as the result of a change in form of business ownership from a partnership or proprietorship to a corporation. Under these circumstances there will be an exchange of property for stock as evidence of ownership in the corporation or bonds or notes as evidence of indebtedness of the corporation. Creation of a proper capital structure should be developed carefully and with expert assistance. Decisions as to amount of stock, value of stock, kind of stock, and various debt instruments can affect greatly the advantages and flexibility of the corporation, particularly in relation to such things as transferability, taxation, management, and credit.

Types of Stock

Principal classes of stock are common and preferred, although these can be voting or nonvoting, par or no-par. Preferred stock can be cumulative or noncumulative, participating or nonparticipating, redeemable or convertible into common stock.

Par. Par value means that stock carries a stated beginning value on the face of the certificate and on the corporation books. Stock shares can be issued at par value or any other value greater than par. They cannot be issued for less than par without violating the Oregon Business Corporation Law. Any consideration received by the corporation greater than par value becomes capital surplus. The creation of capital surplus has certain advantages and adds flexibility to accounting and to the capital structure. Par value can be changed by directors or stockholders depending upon to whom articles of incorporation give such authority. Par value can be any stated amount but $100, $10, and $1 are most common. Lower values have been more common in recent years. One dollar par value is commonly used and is easy to account for. It also makes a stock issue quite divisible and flexible in transfer. A stock certificate can be made out for any number of shares.

Advantages of par value stock of low denomination are primarily in fee saving. Present stockholders may have some protection when par value stock is issued, because sale of subsequent issues of the same class cannot be made at a price below par.

A person receiving stock of an original issue for consideration less than par may be liable to corporation creditors for the difference between the value given and the par value.

No-par. No-par value stock does not carry a stated value on the certificate and may be issued at any price as determined by the board of directors. It is carried on the corporation books at the issued price which becomes the stated capital of the corporation except as the board of directors may allocate amounts up to 25 percent to capital surplus. In absence of fraud, whatever consideration is given for no-par stock is considered fully paid up and no further liability exists. Probably one of the chief advantages of no-par stock is that it makes no pretense of representing a given face value as being the actual value, such as par value stock may lead some people to believe. Either kind of stock, whether par or no-par, represents a share of the total business, value of which may fluctuate from day to day. Neither kind of stock represents a fixed set value. Certain flexibility of accounting is aided by no-par stock.

Common. Common stock usually has voting rights—one vote per each share of stock. In fact, a corporation must have voting common stock to meet requirements of incorporation. Common stock can be par or no-par value but will have no specific rate of return or dividend. Income to a shareholder from stock is called dividends. Dividends will depend upon corporation earnings, but amount of earnings payable as dividends or retained in the corporation is at the discretion of the board of directors.

Preferred. Preferred stock is usually nonvoting and has a par value upon which a fixed dividend rate is established. Preferred stock usually has two characteristics. First, if dividends are declared by corporation directors, preferred dividends must be paid in full at the stated dividend rate before any dividends can be paid to common shareholders. The second characteristic concerns liquidation. Preferred shareholders would receive full return of investment before any return of investment would be distributed to common shareholders. Unless preferred stock is participating preferred, it will not share in any additional earnings of the corporation above the fixed established rate of dividend payment. Preferred stock may have a redeemable feature whereby the corporation at a specific price and/or date can call it in and buy it back. Preferred stock can have a convertible feature which at a given price and/or date can be exchanged for common stock. Preferred stock may be cumulative in that if dividends are not paid in particular years they accumulate and must be paid before any common stock dividends can be paid. An issuance of preferred stock could contain a provision that would give voting privileges to preferred stock in case dividends are not declared in a given number of years. This, however, is not a usual practice.

Choosing a Stock

Farm-ranch owners accepting stock in exchange for farm-ranch property have many choices concerning stock. No general agreement exists as to which type of stock is best. Each kind of stock has its advantages and disadvantages. Each individual case of incorporation is unique and requires different considerations. Whatever the situation, low priced stock will probably be desirable. This is because low priced shares are more flexible in selling, trading, and in making gifts. This flexibility, which is one of the major advantages of a corporation for farm ownership and transfer, would be hampered if shares of stock carried a value too high for easy divisibility and transfer.

If funds are to be acquired by stock sale to outsiders, preferred stock may be used. It offers more security to the purchaser and normally provides a seller certain protection by giving the buyer no opportunity for a voice in corporation affairs.

"Tax-option" corporations which elect to be taxed as partnerships can have only one class of stock. This may have important bearings on the capital structure selected.

Incorporation fees are generally quite moderate and should not be the major consideration in selection of stock type. The Oregon incorporation fee and annual license fee are based on value of authorized shares of stock. No direct relationship need exist between authorized capital stock for fee purposes and actual value of the stock for all other purposes. Therefore, it is possible to keep the fee at a minimum by using relatively few shares of stock.

Remember that actual stock values vary constantly and that for purposes of transfer, gifts, taxes and so forth, stock will be valued at its market value and not at its par value, or in the case of no-par stock, at its issue price. With this understanding and a realization that there need be no direct relationship in Oregon between authorized capital stock and actual value of stock, it is possible to establish a capital structure that will provide for a minimum fee and also provide adequate shares of low priced stock for sufficient division and ease of transfer. A further discussion of fees is included under "Cost of Incorporating."

Bonds and Notes

Bonds or notes, called debt securities, are sometimes used in place of stock. Significant difference exists between owning stock and owning debt securities. An owner of stock receives earnings only after expenses. In the event of insolvency or liquidation, a stockholder will get his investment back only to the degree there are any funds left after all creditors have been satisfied. A holder of bonds or notes would receive annual interest at the stipulated rate, which is an operating expense of the business. Such interest must be paid before any profits of the business can be distributed to owners.

In forming a corporation it may be financially feasible for farm-ranch owners to take in exchange for their property some debt securities instead of ownership stock for the whole amount. In doing so the owner would place property ownership in the hands of the corporation, but instead of taking in exchange evidence of ownership in shares of stock, he would take an evidence of debt as bonds or notes.

Debenture securities. Notes or bonds given in exchange for stockholders' loans are often debenture securities. This means that in the course of creditor claims all other debts would be paid before the debentures. It is usually necessary to use debenture securities when outside money is borrowed. Outside creditors may deem it necessary that stockholders' debts to the corporation be subordinate to theirs. These debenture securities would have claims ahead of any stockholder's rights in liquidation.

Advantages of debt securities. There may be income tax advantages to owners of a closely-held corporation when some notes and bonds are taken instead of all stock. Interest payments are an expense of doing business, whereas dividends to stockholders, whether on common or preferred stock, have to be paid out of net income after taxes. Interest and dividend income are both taxable to the individual, but the corporate income tax is reduced by first reducing taxable income through interest expense payments.

If the stockholders take the "tax-option" and elect to be taxed as a partnership, there will be no federal tax

difference between interest and dividends paid to stockholders. The corporation will pay no tax, and income to an individual will be the same whether it is interest or a share of earnings. In Oregon, however, where the "tax-option" cannot be used for state corporation excise tax, a significant difference may still exist in favor of deductible interest from corporation income.

Holders of bonds or notes have more certain income from a corporation in the form of interest than those depending on dividends from earnings. Likewise, debt securities represent a specific monetary sum, whereas the value of stock may fluctuate widely. However, this fixed monetary value may be a disadvantage during periods of inflation. Bonds or notes might be made to come due in series with the corporation paying off the debt year by year, or the corporation could redeem them when desired. Interest received by bond-note holders with periodic return of investment can be worked in well with retirement programs. Redemption of notes or bonds is generally much easier and the tax problems are less difficult than redemption or sales of stock. Like stock, these bonds or notes can be transferred as gifts or sold, thus adding to flexibility of the capital structure. Certain precautions, primarily with the Internal Revenue Service, must be considered in this debt structure, and a competent accountant or lawyer should be consulted. Retirement of this outstanding debt can be a gradual means of increasing net ownership of younger stockholders. Corporate earnings can be used for this purpose, and as debt is reduced, value of stock should increase. This pattern of debt retirement would be a means of keeping down excess reserves.

Increase Working Capital

When additional funds are necessary for the business beyond what the original owners or promoters have available, the corporate form of business organization is usually, but may not always be advantageous.

Loans. Corporations are not eligible to borrow from the Farmers Home Administration for farm ownership, farm housing, or farm operating loans. Soil and water conservation loans, special livestock loans, and in disaster designated areas production emergency and economic emergency loans will be made.

The Federal Land Bank will make loans to corporations, "but no such loan shall be made to a corporation (A) unless all the stock of the corporation is owned by individuals themselves personally actually engaged in farming operations on the farm to be mortgaged as security for the loan, except in a case where the Farm Credit Administration permits the loan if at least 75 per centum in value and number of shares of the stock of the corporation is owned by the individuals personally actually so engaged, and (B) unless the owners of at least 75 per centum in value and number of shares of the stock of the corporation assume personal liability for the loan. No loan shall be made to any corporation which is a subsidiary of, or affiliated (either directly or through substantial identity of stock ownership) with, a corporation ineligible to procure a loan in the amount applied for."[1]

Production Credit Associations have loan requirements for corporations very similar to those of the Federal Land Bank. Therefore when receiving loans from these agencies the limited liability of the individual stockholder has largely disappeared. Banks and insurance companies generally do not demand the cosignatures of stockholders in order for a farm-ranch corporation to borrow from them. But if the financial condition of the corporation is not strong, personal guarantees of one or more stockholders may be necessary. If corporate management is in the hands of several well-qualified officers who are supported with adequate insurance, stock purchase plans, and retirement benefits, it should make continued good management more certain and loans more secure. The fact that management, continuance of the corporation, or the loan does not depend on the life of a single individual may have favorable influence on lending institutions.

Sale of stock. A corporation can raise capital funds through the sale of stocks or bonds in accordance with Oregon and federal security laws. Potential purchasers are relatives, friends, or the general public. This type of financing for the farm-ranch corporation is not yet widespread. Because most farm-ranch corporations will be family groups, outsiders are apt to be reluctant to purchase stock in a corporation operated primarily for benefit of a family. Being a minority stockholder in a closely held family corporation may fail to provide reasonable returns on investment. General sale of stock or bonds is not likely to be an important immediate source of corporate funds for agriculture, although this may grow in importance as corporate agriculture develops.

Lease or rent. Renting or leasing property for corporate use is also a method of expanding corporation operations and increasing working capital without additional capital expenditure or investment. Rental arrangements may be with individuals or firms entirely outside the corporation, or stockholders, if they wish, may continue to own specific individual property and receive income from it if leased or rented to the corporation. This adds further flexibility to corporate ownership, operation, and income. Farmers or ranchers creating a corporation with the exchange of property might wish to withhold some property from corporate ownership in order to make this flexibility a part of the capital structure.

[1] Laws Administered by the Farm Credit Administration, as amended to Jan. 1, 1957, Farm Credit Administration, Washington, D. C. Circular 20 Revised. p. 51.

Insurance

Officers of a farm-ranch corporation should give careful consideration to insurance programs. Insurance for such things as property damage, crop damage, fire, theft, or livestock loss will probably be the same as with other forms of business organization. But in other types of insurance, such as liability, increased coverage for the corporation may be desirable. Being a corporation will not increase liability according to law, but in some cases it may increase the amount of claim and/or make an adverse court decision more probable. The suit is no longer against a farmer but against an impersonal corporation, although this may not be serious with family farm corporations in local situations.

Employee Benefits

Owner-operators of a corporation are not self-employed persons—they are employees of the corporation. They have all privileges of employees and come under all regulations pertinent to employees. This means officer-stockholders may participate in insurance plans and other fringe benefits accorded employees. They also may come under such employment laws as unemployment compensa-

Unemployment compensation. Agricultural employment in Oregon is presently excluded from unemployment compensation laws.

Workmen's compensation. Agriculture is classed as a nonhazardous occupation in Oregon and thus is not compelled to come under workmen's compensation laws. Nevertheless, farm employers can elect to come under this law. They can receive benefits by making the necessary tion, workmen's compensation, or social security.

contributions which are a percentage of the payroll according to occupation, and a minor deduction from employee wages. Some of these benefits are for injury, disability, and death benefits to survivors of the employee. The law also carries certain liability protection for the employer. Individual proprietors and partners as well as corporation officers may elect to come under workmen's compensation.

Health and Accident

An officer, as an employee of a corporation, can be included in health and accident insurance policies purchased by the corporation for its employees. This insurance is a corporate business expense and need not be included as income to an employee. This is true only for corporations; a proprietorship or partnership cannot do this for owner-officers.

Life Insurance

A group life insurance policy can include officers of the corporation on a basis whereby premiums are deducted by the corporation as an operating expense and need not be included as income to the employee. This arrangement is subject to certain specific requirements in relation to income tax regulations.

Life insurance companies have their individual and varying regulations concerning group policies. Most insurance companies have at least two group plans—a small group plan covering sometimes as few as 3 and up to 25 employees, although 10 is often the minimum, and a large group plan covering 25 and more employees. Some insurance companies will exclude agriculture in small

group plans. Others may exclude agriculture from all group plans. Certain other insurance companies have specific regulations for agricultural firms concerning number and tenure of full-time employees or tenure of the firm itself. Usually the amount of insurance is limited, and a ratio is established limiting amount among classes of employees or officers. The corporation can in no way be a beneficiary to this policy.

Except for the specific case of group life insurance, other life insurance which qualifies as a business deduction by the corporation must be included as income to the employee who would directly or indirectly receive the benefits.

For stock purchase. Stock purchase agreements, discussed in a previous section, are very often funded with life insurance. If the stock purchase agreement is a cross-purchase agreement where surviving stockholders agree to purchase personally the stock of a deceased stockholder, the insurance plan will likely be a "crisscross arrangement." Under this arrangement stockholders will own life insurance policies on each other for the purpose of having funds available to purchase stock of the deceased. For example, A and B would hold an insurance policy on the life of C; A and C would hold a policy on the life of B; B and C would hold a policy on the life of A.

If the corporation is to purchase stock of the deceased, then the corporation would purchase the insurance policy. These insurance premiums are a business expense but are not deductible for income tax purposes. Cash values of insurance policies are assets of the business and are carried on the corporation books as an asset. Redemption of stock belonging to a deceased stockholder would increase the value of the remaining stockholders' share in proportion to each holding.

Insurance makes certain that funds will be available for purchase of stock. Without insurance, funds may not be readily available to purchase this stock. Tax problems of insurance for stock redemption must be carefully considered.

Key man insurance. A principal officer may be of sufficient importance that the corporation may wish to insure his life. This "key man" insurance, as it is often called, may be extremely valuable in helping the company get through a period of adjustment necessary upon the death of a "key man." For example, a farm-ranch corporation centered around a father may depend heavily on his managerial ability or credit standing. His death could make it quite difficult for the corporation to face creditors without a cushion of funds created by insurance. This insurance would be purchased by the corporation and handled as explained for stock redemption.

Credit, debt, or mortgage insurance. Credit or debt insurance might be important to assure continuity of a business if credit is primarily tied to an individual. Often insurance is purchased on this individual for the specific purpose of covering a loan or mortgage, and often the lending institution is made the beneficiary. Some lending institutions have favorable group-plan life insurance to cover all or part of a loan.

Survivor benefit insurance. There is a provision in federal income tax regulations that will allow a corporation to pay a named beneficiary, usually the wife of a deceased employee, a considerable sum of money in consideration of past services performed by the employee.

This sum is a business expense to the corporation and the Internal Revenue Service has generally allowed the beneficiary to receive tax free amounts up to $5,000. This agreement could be backed up with a life insurance policy on the employees so a corporation would have funds to make such a payment.

Estate or inheritance tax insurance. Insurance may be used to provide funds for payment of estate or inheritance taxes where cash may not be available from other sources or where forced liquidation of property would be necessary to pay taxes. However, certain recent provisions of the law allow payment of federal estate taxes in installments over a period of years.

Insurance proceeds and taxes. Life insurance proceeds are generally free of federal and Oregon income tax. In some situations proceeds of insurance may become a part of the deceased estate and become taxable under estate or inheritance tax laws. This can be avoided with proper planning, but the objectives of the insurance should not be overlooked. The key is primarily whether the deceased possessed any "incidents of ownership" in the policies at the time of death. At the time of death he could not have had any right to change beneficiaries or have any power to control the proceeds or use the policy in any way to secure loans and so forth. It is no longer necessary to satisfy the law that the deceased should not have paid premiums on the policies.

In Oregon, insurance proceeds to a deceased estate may be taxable under the Oregon inheritance tax laws as a part of the estate. Proceeds to named beneficiaries on policies issued prior to January 1, 1960, are not taxable as part of the estate. On policies issued January 1, 1960, and thereafter, insurance proceeds become a part of the estate when the decedent had interests in the policies. When there are named beneficiaries, proceeds are exempt from inheritance tax in amounts up to but not exceeding $75,000.

Retirement Programs

As an employee of a corporation an officer has certain retirement opportunities available to him which a proprietor or partner of a business does not have. As a corporation employee, certain tax laws affect him differently.

Social Security

In a sense social security is a tax in that contributions are mandatory. However, an individual obtains certain rights in the form of insurance and in retirement benfits. Social security retirement benefits are a good base around which to organize a retirement program. Parents, for example, can plan to retire from more active operation of the family farm business with an assurance of independent income from social security. Under current law, assuming the requirements had been met for maximum benefits, a man and wife 65 years of age or over can receive about $190 a month. They can still earn $1,200 a year working at a job and receive any amount of dividends, interest, or rent without losing social security benefits. An individual reaching the age of 72 can earn any amount without limiting his social security benefits.

A corporate organization will permit development of a more flexible retirement program. A corporate officer can be retired to an advisory or consultant status and receive social security benefits, maximum salary within provision of the law, interest, dividends, rentals, or income from pension or profit sharing fund. This program can provide a secure and adequate retirement income.

Disability and survivors' benefits. An individual covered by social security and meeting certain requirements after age 50 can receive benefits for total and permanent disability. Upon meeting certain requirements, compensation payments may be received by dependents of a deceased employee.

Agricultural workers covered. By law all regular agricultural workers are required to be covered by social security either as employees or as self-employed persons. Active corporation officers, as indicated earlier, are employees of the corporation and thus come under social security regulations relative to employees rather than self-employed farmers. This affects the tax rate on social security payment. The self-employed pay a tax one and one-half times the amount paid by an employee of a business firm, but the employee's tax is matched by contributions made by the employer in behalf of the employee. The total payment is greater where both employee and employer contribute than for the self-employed. The apparent differential is reduced, however, because the employer, for tax purposes, deducts social security contributions as a business expense. (Table 9).

TABLE 9. Social Security Tax Rates

Date	Self-employed rate	Employer and employee rate	Total employer-employee rate
	Percent	*Percent*	*Percent*
1960-62	$4\frac{1}{4}$	3	6
1963-65	$5\frac{1}{4}$	$3\frac{1}{2}$	7
1966-68	6	4	8
1969	$6\frac{3}{4}$	$4\frac{1}{2}$	9

Although the rate for self-employed persons is less than the combined rate of employer and employee in a corporation, the benefits are identical. The agricultural employer, if he wishes, may pay the full social security tax including the employee's share.

Benefits based on contributions. Contributions to social security are based on a percent of wages up to a total of $4,800. The amount of benefits depends on the average monthly wage. This is computed by taking the average of the years beginning with 1951 and dropping out the five years having the lowest income.

Income of self-employed farmers may vary from year to year. Some years the income may not equal the maximum income necessary to establish the highest possible base for benefit payments. With a corporation wherein the individual would be an employee, a salary could be established according to services rendered and independent of the farm corporation earnings. The salary could be established at least at the maximum for social security benefit purposes even though at times the corporation suffers a loss. This would help establish a high base for benefit payments. Thus a farmer nearing the age of retirement could use this device to establish a higher retirement benefit base than might otherwise be possible.

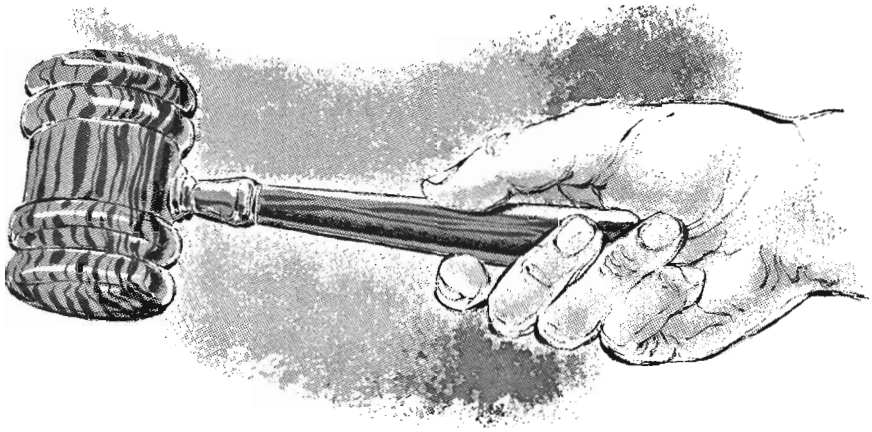
Family labor. One other difference between corporate and noncorporate social security regulations is treatment of family labor. An individual working for members of his own family—son, daughter, or wife—is exempt from social security. A child under the age of 21 working for his father is also exempt. But, any person, regardless of age, working for a corporation comes under the social security law.

Pension and Profit-Sharing Plans

Any business firm, whether a sole proprietorship, a partnership, or a corporation, can establish a pension or profit-sharing plan for its employees by setting aside a fund, or by using life insurance annuities or investment trusts. However, most business plans are tailored to take advantage of certain tax allowances. For the benefit of owners, plans which take advantage of tax-exempt payments to a fund are presently limited to corporations. Owners or stockholders of a business must come under the plan as corporate employees in order to take advantage of the tax benefits.

There are numerous plans, both current and deferred payment types, to meet various purposes. Some are incentives to hold good employees, to increase interest in the business, or to provide retirement income. Establishment of a plan needs careful planning and qualified technical and legal advice as well as approval of the Internal Revenue Service for certain tax-exempt plans. The basic plan provides for a payment by the business into a trust fund. This payment is sometimes matched or added to by the employee. The payment can be a set amount or an established percentage of salary or profits, although generally 15 percent of the total compensation paid to those under the plan is the maximum tax free deduction allowable. The corporation's payment to the pension fund under an Internal Revenue accepted plan is deductible by the corporation as a business expense. The employer contribution to the retirement fund need not be included as income to the employee until actually received by him. This usually results in tax saving because a retired individual is often in a lower tax bracket. These funds are often invested in a trust fund which may purchase stock, bonds, life insurance, annuities, or may, under certain stringent conditions, be loaned back to the corporation. The corporation may have need of this fund for working capital.

Upon meeting certain requirements for retirement or withdrawal from the company as established by the plan, an employee is eligible to receive a settlement. The settlement can be either lump sum, monthly payments, or a share of the fund. This fund could well serve to supplement social security retirement benefits.



Legal Requirements for Incorporating

Certain legal requirements must be met before a corporation can receive its charter and do business.

Basic Requirements

Basic requirements in Oregon are relatively simple. There must be three or more incorporators--natural persons (not corporations) who are at least 21 years of age. A corporation may not begin business until at least $1,000 or property value of that amount has been paid in for issuance of stock, unless total authorized shares of par value stock is less than $1,000, is fully paid up, and only par value stock is authorized.

Preincorporation Agreement

Assuming these basic requirements will be no barrier to incorporating, a preincorporation agreement should be drawn up. This agreement is not legally necessary and can be oral or written. But a more formal written agreement may be desirable, particularly if more than one major stockholder is involved. Certain things would have to be agreed upon before incorporation would be desirable.

The type of stock, number of shares to be authorized and issued, price and agreements to purchase stock, or the property to be exchanged will be particularly important. Certain precautions must be taken to make this exchange a nontaxable transaction. Any use of bonds or notes should likewise be included in the agreement.

A certain understanding needs to exist concerning stockholders who will be employees, officers, and directors, even though official election of directors and officers cannot come until after the charter has been granted. Salary agreements are desirable prior to incorporation. Duties and obligations of officers should be spelled out.

Any arrangements concerning such things as stock transfer restrictions, purchase agreements, voting trusts, and life insurance funds should all be a matter of agreement and record. A method for evaluating stock in transfer or purchase should be included to reduce later disagreement. This is usually not an easy matter and may be done by accepting book value, market value, appraisal value, or some other agreed value.

Since corporations, particularly from a tax standpoint, can be costly to dissolve, every precaution should be taken and every possible area of conflict eliminated prior to incorporation. Thus attempting to arrive at a preincorporation agreement may prove it is undesirable to incorporate, but this is better found out before than after incorporation.

Articles of Incorporation

In Oregon, following all preliminary agreements, articles of incorporation signed by three incorporators must be presented to and endorsed by the Corporation Commissioner. Persons seriously contemplating incorporating in Oregon should get a copy of *Oregon Business Corporation Law Relating to Domestic and Foreign Stock Corporations*, published by the State of Oregon, and available from the Corporation Commissioner, Salem, Oregon. A lawyer familiar with Oregon corporation law should be consulted to draw up articles of incorporation. Articles may be amended by approval of stockholders and endorsement by the Corporation Commissioner.

Some general requirements to be included in the articles of incorporation are . . .

Name. Corporation name must be stated and must contain the word corporation, company, incorporated or limited, or an abbreviation of one of such words. The name cannot be the same or similar to the name of any existing domestic corporation in the state. Therefore, a chartered corporation has the exclusive right to the name it chooses. This may have valuable prestige or advertising

value. Even prior to incorporation a corporate name may be reserved and renewed year-to-year by making application and payment of a nominal fee.

Life. A corporation may have a stated life in years, or it may have perpetual life as long as requirements are fulfilled. Its life must be stated in the articles of incorporation. Most corporations have a perpetual life rather than a life in years because if desirable, they can be terminated at any time by fulfilling certain legal requirements.

Purpose. Nature of business to be pursued by the corporation must be stated. This section usually is written carefully so that broad general operation and expansion of business activity will be possible without violating terms of the corporation charter.

Authorized capital stock. A statement is necessary regarding the number of shares, classes of stock, and if par or no-par stock of each class is to be issued. Any limitations or special rights of stocks must be listed.

Registered agent and office. A corporation is required to maintain an office and a registered agent to whom official communication can be directed. This agent can be a corporation officer at his home or office or it can be another business firm or lawyer. One corporation to act as agent for another corporation must have such authority provided in its articles of incorporation.

Incorporators and directors. A listing is required of the name and address of each incorporator (minimum of three) and each director who is to serve until official elections are held. Three directors are required in Oregon, none of whom need to be stockholders or residents of Oregon.

Certificate of Incorporation. It is required that duly signed duplicate originals of the Articles of Incorporation be delivered to the Corporation Commissioner together with the appropriate fee. If found to be in order, the Commissioner will endorse the Articles with "filed" indicating the month, day, and year. He will then issue a Certificate of Incorporation, and the corporation will have come into being. The Articles of Incorporation filed with the Corporation Commissioner are a matter of public record. They can be changed only by official amendment. The corporation may then commence business as soon as at least $1,000, or property of this value, has been paid into the corporation for issuance of shares, or if stock is par value and the total authorized stock is less than $1,000, is fully paid up, and only par value stock is authorized. An organizational meeting should follow immediately to elect directors officially, appoint officers and adopt bylaws, as well as handle other organizational procedural matters.

Bylaws

Bylaws are the regulations directing internal affairs of a corporation. They are approved by the board of directors, and they can be changed by the board of directors unless changes are reserved to the stockholders by the Articles of Incorporation.. Bylaws are general guides for conduct of business. They are arranged under properly designated headings called "articles" and numbered consecutively for reference purposes. Each article may be subdivided into numbered sections. The following provisions are usually included in bylaws.

Business description and location. Although name of the corporation and the registered office and agent are included in articles of incorporation, certain other information of this nature should be repeated and possibly expanded in the bylaws. They should include business location, address of business offices, and so forth.

Fiscal year. A fiscal year must be designated for the corporation. It may agree with the normal calendar year or coincide with some more natural business year. There may be some natural time of year when crops have been sold or inventories are at their lowest which would work best to end and commence the business year. This choice of fiscal year may be important for income tax purposes.

Corporation seal. The corporation "signature" is a seal which should be described in bylaws and its use authorized. This seal can be made as desired and should be used on all official corporation documents.

Stockholders meetings. Provisions should be made to establish date, time, and place for required yearly stockholders meetings and to call any special meetings as prescribed by law. Written notice must be given of special meetings not less than 10 nor more than 50 days prior to such meetings. State law requires that in order to conduct corporation business a majority of shares entitled to vote must be represented, either personally or by proxy. A larger vote may be necessary if the bylaws so require.

Voting rights. Each share of stock outstanding is entitled to one vote in matters brought before stockholders. It is the stockholders' responsibility to elect the board of directors. In election of directors each stockholder has votes equal to the number of shares owned multiplied by the number of directors to be elected. If cumulative voting is to be allowed, it must be so stated in the Articles of Incorporation. Cumulative voting allows minority stockholders the right to obtain some representation on the board of directors. Minority stockholders by massing their votes can elect at least one director instead of spreading their votes out and allowing the majority to elect all directors. Other specific requirements concerning voting should be checked with state law.

Election of directors, duties, and meetings. Bylaws should state the number of directors. Oregon law requires three. They need not be residents of Oregon or stockholders unless the Articles of Incorporation require it. Qualifications and manner of election should be spelled out as well as terms of office and salaries if any. Any special provisions concerning directors meetings should be explained. General or specific duties of directors should be listed giving them certain rights and responsibilities or withholding certain authority or rights. Directors' voting procedures and procedures for election or selection of corporate officers should be included.

Officers and their duties. Officer positions in a corporation should be stated in the bylaws. Oregon law requires a corporation to have a president, one or more vice presidents, a secretary, and a treasurer elected by the board of directors. Any two or more offices may be held by the same person except those of president and secretary. General duties and range of salaries might be included in the bylaws, but they should not be made so rigid as to be unworkable.

Special acts or restrictions. Any special powers given to or limitations placed on officers or directors of a corporation should be contained in bylaws. Some of these powers or limitations might include powers concerning purchase or sale of real property, borrowing of funds, mortgaging of property, or execution of contracts. A general dividend policy might be included in bylaws.

Amendments. A simple procedure should be developed for amending bylaws. However, bylaws and other rules and regulations—except as state law requires—should be kept simple and flexible. In most family farm-ranch corporations the same people will be stockholders, directors, and officers, and there is no need for elaborate regulations concerning one group's relations with another. Considerable freedom of action should be maintained without the necessity of changing or modifying rules. However, when stockholders, directors, and officers of a corporation are all different people, more specific rules should be included.

Records and Reports

After articles of incorporation have been filed, they can be amended as desired from time to time by application to and acceptance by the Corporation Commissioner. Any change in registered office or agent must be reported to the Corporation Commissioner.

A corporation is required by state law to "keep correct and complete books and records of accounts and shall keep minutes of the proceedings of its shareholders and board of directors"; also a record of its shareholders is required giving names and addresses with number of shares and class of stock held. This record must be current with all transfers.

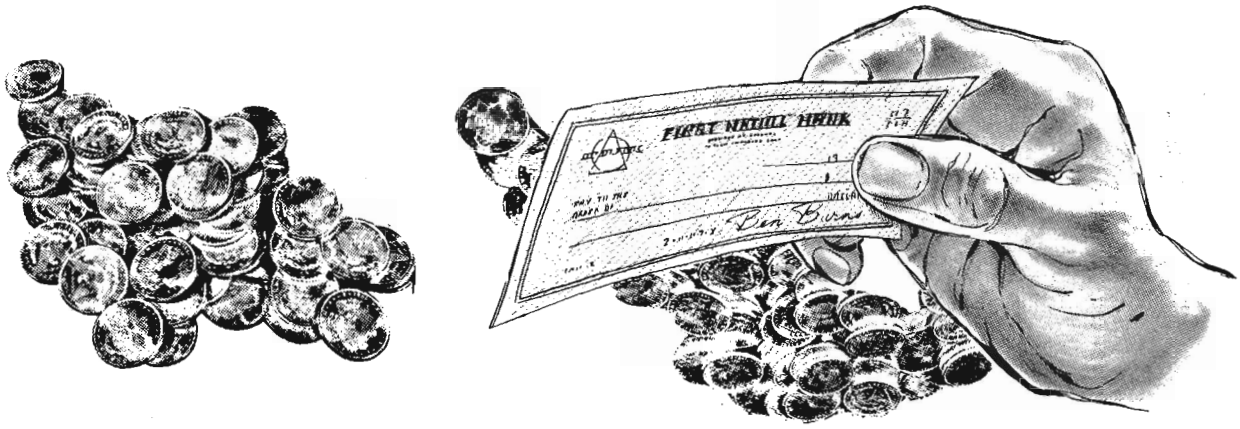
Annual report. All corporations registered in Oregon are required to file an annual report with the Corporation Commissioner. Information contained in this report shall be given as of 30 days before the anniversary date of the corporation. This report and accompanying fee is due the 15th day of the second month following the corporation's anniversary. A special one-page form is supplied by the Corporation Commissioner. This report is primarily to determine changes in officers and capital structure and provide a billing form for payment of annual license fee.

Registration of securities. Registration of securities with the federal Securities and Exchange Commission may be necessary under certain conditions. This registration, except for specific exemptions, is required of all securities offered for sale in interstate commerce or through the mails. The exemption most likely to apply to farm-ranch securities is that issues of $300,000 or less need not be registered. But notification of the proposed offering must still be given and a short waiting period is necessary before an issue can be offered to the public. Any public issue of more than $50,000 must be accompanied by an offering circular which spells out in considerable detail the facts of the issue. It will be necessary to consult federal securities regulations in detail if an issue is to be sold in interstate commerce or if mails are to be used.

Oregon corporation securities, except for certain express exemptions, are regulated by "Oregon Securities Law" administered by the Corporation Commissioner.

The exception to this discussion is that preorganization subscriptions can be sold without registration if the total number of persons solicited does not exceed 25 or the total number of persons subscribing to the issue does not exceed 10. To remain exempt all subsequent subscriptions must be to holders of securities previously issued and shall not exceed 10 persons.

With many farm-ranch corporations, registration of securities will not be necessary either in creating a corporation or raising additional funds afterwards. If registration is necessary, explicit requirements will have to be satisfied and specific reports filed with the appropriate commission.



Cost of Incorporating

There are several costs in connection with a corporation that do not exist with other types of business. These will have to be added to the disadvantages of incorporating. Incorporation costs at first glance may seem large and an additional expense of doing business. Except for the recurring annual license fee, and usually some additional accounting and legal fees, other costs of incorporating are incurred only once and can be written off or amortized over a period of years. Therefore, if the corporation as a tool of financial planning and management has any significant value to a farm business, costs of incorporating should be only a minor determinant in the decision of whether to incorporate.

Incorporation and License Fees

Oregon requires an initial incorporating fee which must be paid at filing of Articles of Incorporation. An annual license fee must also be paid. Both of these fees are based on value of authorized capital stock. This is the value of stock authorized to be issued and stated in the articles of incorporation. This does not necessarily mean actual shares outstanding. There may be more shares authorized than issued. Because fees are based on value of authorized capital stock, authorized value should not significantly exceed (within range limits) the total amount of stock contemplated to be issued. Authorized capital stock can be increased at a later date, if desired, by amendment to the articles of incorporation.

Table 10, based on value of authorized shares, currently applies in Oregon for filing articles of incorporation and paying the annual license fee. Par value stock is valued at its par value and no-par stock for fee purposes is deemed equivalent to shares having a par value of $10 each.

Fees will be only one consideration as to whether par or no-par value stock is used, but it may help to decide if other aspects are considered unimportant to a specific case. Closely-held or family corporations will not be concerned with many of the considerations of corporations that sell stock to the public.

TABLE 10. Oregon Fees for Filing Articles of Incorporation and Annual License Fee

If total value of authorized shares exceeds	But does not exceed	Fee
$ 0	$ 5,000	$ 10
5,000	10,000	15
10,000	25,000	20
25,000	50,000	30
50,000	100,000	50
100,000	250,000	75
250,000	500,000	100
500,000	1,000,000	125
1,000,000	.....	200

Fees are only one consideration in selecting the stock. But the fee does depend upon which stock is selected and the value at which it is issued.

Number of shares authorized to be issued multiplied by par value will give total value of authorized shares. The required fee can be read from Table 10. For no-par stock, number of shares authorized to be issued multiplied by $10 will give the total value of authorized shares and the applicable fee is also shown in Table 10.

Since value of stock (whether par or no-par) for fee purposes need not coincide directly with actual value of stock, any par value stock of less than $10 per share would be a fee saving over no-par stock for any equal number of shares. For any given fee, use of $1 par value stock would allow 10 times more shares to be issued than if no-par stock were issued. This is because no-par stock

for fee purposes is fixed at $10. Conversely no-par stock with issue price greater than $10 per share will mean a fee saving over issuing par value stock at greater than $10 per share.

Federal Stamp Tax

A federal stamp tax must be paid on the original issue of stock. Tax stamps are purchased from a post office and are affixed to the stock book. Stamps are cancelled when stock is issued. The current rate is 10 cents per $100 (or major fraction thereof) of actual value of certificates (or of shares where no certificates are issued).

A stamp tax applies also to each transfer of stock after it has been issued. This transfer tax is at the rate of 4 cents on each $100 (or major fraction thereof) of actual value of shares. In no case will tax be more than 8 cents per share or less than 4 cents on sale or transfer.

The original issue of certificates of indebtedness (bonds, debenture notes, and so forth) is likewise subject to stamp tax but at a rate of 11 cents per $100 or fraction of face value of each certificate. Transfer tax on certificates of indebtedness is 5 cents per $100 or fraction thereof.

Cash consideration in transfer of real property likewise is subject to this tax at the rate of 55 cents for each $500 or fractional part thereof.

Oregon has no issuance or transfer tax.

Organizational and Legal Fees

Because of technical and legal procedures involved, it would not be advisable to incorporate without services of a competent lawyer and tax accountant. These services may be extensive depending upon the amount of consultation and detailed planning necessary and how involved the corporation documents and interagreements are. Or services may be limited to a simple matter of executing a standard article of incorporation form.

No specific cost for legal services can be given but the Oregon Bar Association recommends the following minimum schedule:

Simple incorporation, ($1000 authorized capital stock)	$200
Dissolution, (without tax implications)	100
Amendments to Articles of Incorporation	50
Mergers	200
Corporation meetings and minutes	25

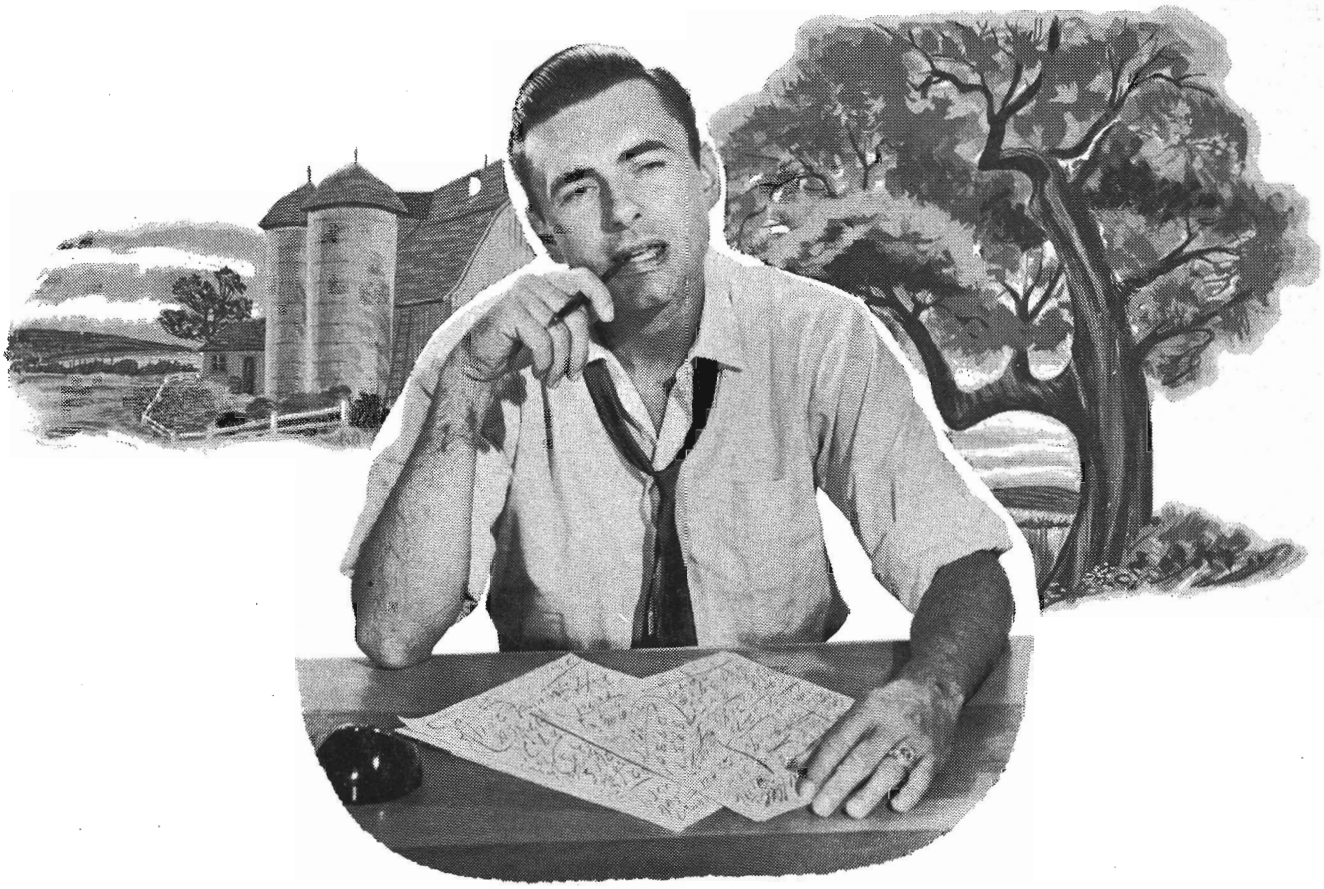
There will be additional charges for specific legal instruments, such as buy and sell agreements or voting trusts. There also may be additional consultation needed for which an attorney may charge on a time-spent basis. Many businesses pay for legal aid on a monthly retainer fee basis. This may be advisable if regular legal services are used.

Incorporation usually requires a legal fee of between $250 and $300.

A rough estimate of total incorporation costs, if 1,000 shares of no-par value stock were authorized, follows:

Initial filing fee (Oregon)	$ 15.00
Annual license (assume full year)	15.00
Federal stamp tax	100.00
Attorney and accountant fees	350.00
	$480.00

There would be an annual license fee of $15 and a federal stamp transfer tax on all stock transferred thereafter. These costs of incorporation for federal income tax purposes cannot be written off in the year in which they occur but can be amortized or written off over a period of several years.



Dissolving a Corporation

Since the state authorizes formation of a corporation, the state must also authorize its dissolution. State law provides specific details to be followed. As certain legal requirements are necessary to form a corporation, certain legal requirements are necessary to dissolve one.

Voluntary

People who formed a corporation by common consent can agree to dissolve it by common consent. Thus unanimous written consent of stockholders can bring about a dissolution. There are certain requirements concerning a notice to all creditors and to the Corporation Commissioner of intent to dissolve. Certain other requirements should be examined carefully in relation to law and with assistance of an attorney.

Involuntary

When certain situations occur, a corporation in Oregon may be dissolved involuntarily by a proclamation from the Governor. There are several acts which may bring about dissolution: failure to file annual reports, pay annual fees, maintain registered agent and office, to notify of changes in articles of incorporation, registered agent, or place of business.

Court action can bring about dissolution of a corporation as a result of a suit by creditors to liquidate assets to pay debts. By court action stockholders can bring about dissolution to get relief from illegal, fraudulent, or oppressive action by directors or officers when they cannot be removed as a result of voting deadlocks, and so forth.

Problems

Professional legal and accounting services necessary in forming or dissolving a corporation can be rather large. Income tax problems associated with dissolution can become quite serious in certain situations. Careful planning and preparation should go into forming a corporation or possibly deciding not to form one. It can be much less costly to form a corporation than to dissolve one.

CORPORATION FORMS USED IN OREGON

J203 6

FOLD AND CREASE HERE BEFORE SHAPPING OUT CARBONS

STATE OF OR
MAIL TO: CORPORATION DEPA
SALEM, OREGON

DOMESTIC

ANNUAL STATEMENT AS OF FEBRUARY, 1961

FEE BILLING FOR FEBRUARY, 1961 to FEBRUARY, 1962

THIS BOX FOR USE OF THE CORPORATION DEPARTMENT

DATE AND NUMBER | CASHIER | AMOUNT 00000

DATE CERTIFICATE OF INCORPORATION ISSUED AND DURATION: 2-12-0000 perpetual

Date Due APRIL 15th

AUTHORIZED CAPITAL STOCK ITEMIZED BY CLASS, PAR VALUE AND SERIES: $10,000 Com $100; $25,000 Pref $1

CORPORATION: JOHN DOE RANCH, INC. 00000

ANNUAL FEE $30.00 PAY

REGISTERED AGENT: JOHN DOE
REGISTERED OFFICE: 000 SCHEMIFRE ST. ANYPLACE, OREGON

RETURN ORIGINAL (WHITE) COPY WITH YOUR REMITTANCE. PENALTIES AND INTEREST WILL BE CHARGED IF NOT SUBMITTED BY "DUE DATE" AS PRINTED ABOVE.

PLEASE READ ALL INSTRUCTIONS ON REVERSE SIDE CAREFULLY. INCORRECT OR INCOMPLETE STATEMENTS CANNOT BE ACCEPTED.

MAKE ALL REMITTANCES PAYABLE TO: OREGON STATE CORPORATION DEPARTMENT.

YOUR CANCELLED CHECK PROVIDES EVIDENCE OF PAYMENT. NO RECEIPT WILL BE FURNISHED.

2. NAMES AND ADDRESSES OF PRINCIPAL OFFICERS
ENTER NAMES AND COMPLETE ADDRESSES—STREET AND NUMBER, CITY, STATE

NAME OF PRESIDENT
ADDRESS
NAME OF SECRETARY
ADDRESS
NAME OF TREASURER
ADDRESS

1. ITEMIZATION OF AUTHORIZED CAPITAL STOCK
THE ITEMIZATION OF AUTHORIZED CAPITAL STOCK IMPRINTED ABOVE SHOWS THE CAPITAL STOCK AUTHORIZED BY ARTICLES AND AMENDMENTS FILED WITH THE CORPORATION DEPARTMENT. INCREASING OR DECREASING CAPITAL STOCK MUST BE FILED WITH THE CORPORATION DEPARTMENT ACCOMPANIED BY PROPER

3. CAPITAL STOCK AS OF 30 DAYS PRIOR TO

CLASS OF STOCK	PAR VALUE	THE ISSUED PRICE PER SHARE OF NO PAR VALUE STO	
		PRICE PER SHARE AT WHICH NO PAR VALUE STOCK WAS ISSUED	SUBS
PAR VALUE COMMON			
NO PAR VALUE COMMON			
NO PAR VALUE PREFERRED			
		PAR PREFERRED	

4. A BRIEF STATEMENT OF THE CHARACTER OF THE BUSINESS IN WHICH THE CORPORATIO

CERTIFICATION—MUST BE SIGNE

Submit in duplicate

NO. 57.1-A CERTIFICATE OF INCORPORATION

File No. 00000

Notice:
© The corporate name shall contain the word "corporation", "company", "incorporated" or an abbreviation of one of such words.
© Owing to the statutory powers and duties of the corporate officers, it may be necessary to be fully informed as to the rights and powers so on it there are additional classes of shares or a statement as to the respect of the shares of each class.

File No.

Articles of Incorporation

OF

Business—For Gain

SPECIMEN

State of Oregon

CORPORATION DEPARTMENT

STATE OF OREGON 1859

Certificate of Incorporation

OF

JOHN DOE RANCH, INC.

The undersigned, as Corporation Commissioner of the State of Oregon, hereby certifies that duplicate originals of Articles of Incorporation, duly signed and verified pursuant to the provisions of the Oregon Business Corporation Act, have been received in this office and are found to conform to law.

ACCORDINGLY, the undersigned, as such Corporation Commissioner, and by virtue of the authority vested in him by law, hereby issues this Certificate of Incorporation and attaches hereto a duplicate original of the Articles of Incorporation.

SPECIMEN

In Testimony Whereof *I have hereunto set my hand and affixed hereto the seal of the Corporation Department of the State of Oregon, at Salem, this 17th day of January, 1961*

Frank J. Healy
Corporation Commissioner

By Clark A. Brown

Articles of Dissolution by Incorporators

Articles of Dissolution by Incorporators

of

Pursuant to the provisions of ORS 57.526 of the Oregon Business Corporatio being a majority of the incorporators of the corporation hereinafter named, ad Dissolution:

FIRST: The name of the corporation is

SECOND: The date of issuance of its Certificate of Incorp

THIRD: None of its shares has been issued.

FOURTH: The corporation has not commenced busir

FIFTH: The amount, if any, actually paid in on r of for necessary expenses, has been returned to the

SIXTH: No debts of the corporation rem

SEVENTH: A majority of the incorp

Dated

Index

Page

Advantages
- Of debt securities 17
- Of incorporation 3

Agreements
- Buy-sell of stock 7, 8, 20
- Cross purchase of stock 20
- Preincorporation 23
- Stock purchase and transfer 7, 8, 20
- Voting trust 7, 13

Amendments
- To articles of incorporation 23, 24, 25
- To bylaws 25

Annual license fee 4, 26
Annual meeting 8, 24
Annual report 25
Articles of incorporation
- Amendments 23, 24, 25
- Contents of 23, 24
- Filing with commissioner 24

Artificial legal being 5
Assets and liabilities
- Corporate 5
- Personal 8
- Stockholder 5

Authorized capital stock 17, 24, 26, 27
Board of directors (see also directors) 5
Bonds and notes 17
Business description and location 24
Buy-sell agreements 7, 8, 20
Bylaws, description and contents 24, 25
Capital, raising outside 3, 18
Capital gains and losses 11, 12
Capital stock authorized 17, 24, 26
Capital surplus 16
Capitalization and credit structure 16
Certificate of incorporation 24
Certificate of stock 6, 16
Closely-held corporations 7
Common stock 17
Continuity of ownership and management 3, 7
Contracts of corporation 5, 8
Control of corporation 7
Control of corporation yet transfer property 7
Convertible preferred stock 17
Corporate securities 3, 16-18
Corporation
- A form of ownership 5
- A legal person 5
- A management tool 5
- Documents 29
- Life of 3, 5, 6, 24
- Limited liability of 3, 6, 8
- Nature of 5
- Purpose stated 24
- Rights of 5
- Seal 24

Costs
- Disadvantage of corporate structure 4, 26
- Of incorporating 26

Credit structure and capitalization 16
Credit, debt or mortgage insurance 20
Crisscross insurance 20
Cross purchase stock agreement 8, 20
Cumulative preferred stock 17
Cumulative voting rights 24
Death of stockholder 7
Debenture securities 17
Debts
- Of corporation 8
- Of stockholders 8

Page

Debt securities, advantages of 17
Description and location of business 24
Directors
- Agents of the corporation 8
- Authority of 8
- Duties of 8, 24
- Election of 8, 24
- Meetings 24
- Number required by law 7, 24
- Personal liability of 8
- Responsibilities of 8, 24

Disability and survivors' benefits, social security 21
Disadvantages of incorporation 4
Dissenting stockholders 7, 8
Dissolution of corporation 4, 28
Dissolving a corporation
- Voluntary 28
- Involuntary 28
- Problems of 28

Dividends
- Common stock 16, 17
- Paid out after taxes 17
- Preferred stock 17
- Taxation of 10

Division
- Of ownership 3, 5, 6
- Of property 6

Double taxation 10
Double tax eliminated 13
Election
- For tax-option corporation 13
- Of directors 5, 24
- Of officers 25

Employee benefits, insurance 19
Estate
- Management 3, 5
- Tax, federal 13
- Tax, Oregon 14
- Insurance for estate taxes 20

Evaluation of stock
- For estate tax purposes 8
- For transfer agreement 8
- In preincorporation agreement 23

Excise tax, Oregon Corporation 13
Expense, additional with corporate business 4
Family corporation 7
Family labor and social security 22
Farm-ranch corporations
- Numbers of 6

Farmers Home Administration loans 18
Federal Land Bank loans 18
Federal tax
- Corporation income 10-13
- Estate 13-14
- Gift 14-15
- Stamp 4, 27

Fees
- Based on authorized shares 17
- Incorporation 26
- Legal 27
- License 26
- Minimum possible 16, 17, 26
- Organizational 27

Fiscal year 24
Financial management 5
Forms, for Oregon corporations 29
Fringe benefits 3, 6, 19, 21

Page

Gifts
- In contemplation of death 13, 14, 15
- Irrevocable 14

Gift Taxes
- Annual exclusion 14
- Federal 14-15
- Lifetime exemption 14
- Oregon 15

Health and accident insurance 19
Home, ownership of 9
Homestead exemption, Oregon 9
Income taxes
- Corporation, advantages 11
- Corporation, disadvantages 4, 10
- Corporation, federal 10-13
- Oregon excise 13

Incorporation
- Articles of 23
- Costs of 26
- Fees 4, 26
- Procedures 23

Incorporating, when to consider 6
Incorporators 23, 24
Increase working capital
- Lease or rent 18
- Loans 18
- Sale of stock 18

Individual property 6
Inheritance tax, Oregon 3, 14
Insolvency 8
Insurance
- Employee benefits 19
- Health and accident 19
- Liability 19
- Life (see life insurances also) 19
- Unemployment Compensation 19
- Workmen's compensation 19

Interest
- On bonds and notes 17, 21
- Expense, deducted before taxes 17

Introduction 3
Involuntary dissolution 28
Joint ownership of property 5, 6
Joint tenants 6
Key man insurance 20
Lawyer fees 4, 27
Lease or rent property
- Stockholders to corporation 6, 18, 21
- For additional working capital 18

Legal
- Fees 27
- Person, a corporation 5
- Requirements for incorporating 5, 23
- Status of corporation 5

Liability (see limited liability also)
- Of directors 8
- Of officers 8
- Of stockholders 8
- Personal, with corporate loans 9

License fee, corporation 26
Life insurance
- Buy-sell agreements 8, 20
- Credit, debt or mortgage protection ..20
- Crisscross stock purchase 20
- Estate or inheritance tax payments ..20
- Group policies 19
- Key man 20
- Policy, ownership of 8
- Stock purchase 20
- Survivor's benefit 20
- Taxation of proceeds 20

Page
Life of corporation 3, 5, 6, 24
Limited liability for
Corporations 3, 6, 8
Corporate loans—sometimes none 9, 18
Limited partnership 9
Partnerships—none 9
Proprietorships—none 9
Separate businesses 6, 8
Stockholders 8
Limited partnership 9
Loans with
Banks 9
Farmers Home Administration 18
Federal Land Bank 18
Insurance companies 9
Production Credit Associations 18
Losses, capital gains and 12
Losses, operating 13
Management
Group 7, 8
Managers, separate from owners 5
Market for stock 8
Meetings
Annual 8, 24
Organizational 24
Stockholders 8, 24
Multiple ownership 6
Name of corporation 23
Nature of a corporation 5
Negligence of corporation agents 8
Nonvoting stock 16
No-par stock
Description of 16
Value for fee purposes 26
Notes and bonds 17
Notes, in capital structure 17
Officers
Duties, responsibilities 8, 25
Personal liability 8
Operating losses 13
Operation and management 8
Oregon
Business corporation law 23
Corporation excise tax (income) 13
Estate tax 14
Gift tax 15
Incorporating requirements 23
Inheritance tax 14
Securities law 25
Organizational
Meeting 24
Fees 27
Procedures 23
Owners and managers separated 5
Ownership
Corporation, a form of 5
Division of 3, 6
Transfer of 3, 6
Participating preferred stock 17
Partnerships
A form of business ownership 5
Dissolves at death of partner 7
Limited 9
Limited liability 9
Property 6
Uniform Partnership Act 6
Par-value stock
Description 16
Value for fee purposes 26
Pension and profit-sharing plans 22
Perpetual life of corporation possible 3, 24

Page
Personal
Assets protected 8, 9
Debts of stockholders 8
Liability possible with corporate loans 9
Property 9
Preferred stock 16, 17
Preincorporation agreement 23
Price of stock 8
Problems of dissolution 28
Production Credit Association loans 18
Profit-sharing plans 22
Property ownership
Joint tenant 6
Partnership 6
Tenants in common 6
Proprietorship
Dissolution 7
Form of business organization 5
Limited liability—none 9
"Pseudo-corporation" 12
Purchase and transfer agreements, stock.... 7
Purpose of corporation 24
Qualifications for a "tax-option" corporation 13
Records 4, 25
Redeemable stock 17
Registered agent and office 24
Registration of securities 25
Rental of property 6, 18
Report, annual 25
Requirements to incorporate 5, 6, 23
Restrictions of corporation 25
Retirement programs 21-22
Rights of a corporation 5
Salaries, reasonable, for internal revenue purposes 10
Sale of Stock 18
Seal, corporation 24
"Section 1231 transactions" 11
Securities and Exchange Commission 25
Securities
Debenture 17
Debt 7, 17
Registration of 25
Shareholders (see stockholders)
Share of business represented by stock 5
Size, not a prerequisite to incorporation 5
Small business corporation 12
Social Security
Agricultural workers covered 21
Benefits 21
Benefits based on contribution 22
Disability and survivors' benefits 21
Earnings in addition to 22
Family labor 22
Rates 22
Special acts or restrictions 25
Specific property 6
Splitting income for tax purposes 6, 11
Stamp tax, on stock transfer 4, 27
State Industrial Accident Commission 9
Stock
Capital, authorized 24
Choosing a stock 17
Classes limited for tax-option corporation 13, 17
Common 17
Convertible preferred 17
Cumulative preferred 17
Low priced, advantage of 17

Page
Market for 8
Nonvoting 17
No-par value stock 16
Of deceased stockholder 7, 8, 20
Participating preferred 17
Par value 16
Personal property 9
Preferred 17
Purchase and transfer agreements 7, 8, 20
Redemption 20
Sale of 18
Types of 16
Voting stock 17
Stockholders
Death or withdrawal 7, 8, 20
Dissenting 8
Limited liability 8
Meetings 8, 24
Personal debts of 8
Numbers limited for "tax-option" corporation 13
Responsibilities 8
Stock purchase agreement 7
"Subchapter S"
Corporation, described 12-13
Election to become 13
Survivor benefits
From corporation 20
Social Security 21
Tax-option corporation
Capital gains and losses 12
Double tax eliminated 13
For Oregon tax not allowable 13, 17
Operating losses 13
Qualifications for 13
Taxes
Alternative tax on capital gains 11
Capital gains 11, 12
Double taxation 10
Double tax eliminated 13
Dividends 10, 11
Federal estate 13
Federal gift 14
Insurance proceeds 20
Operating losses 13
Oregon corporation excise 13
Oregon estate 14
Oregon gift 15
Oregon inheritance 14
Partnerships 10
Proprietorships 10
Rates 10-15
Sale of depreciable property 11
Tenants in common 6
Transfer
Agreements, stock 7, 20
Of ownership 3, 6
Ownership but maintain control 7
Trusts, voting 7
Unemployment compensation 19
Uniform Partnership Act 6
Voluntary dissolution 28
Valuing stock 8
Voting
Cumulative rights 24
Rights 24
Stock 17
Voting trust 7, 13
Working capital, increase 18
Workmen's compensation 8, 19