AGRICULTURAL ECONOMICS

May 10, 2017

agecon.unl.edu/cornhuskereconomics

Cornhusker Economics

Family Feud Ends Up in Court

Market Report	Year Ago	4 Wks Ago	5-8-17
Livestock and Products, Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight.	128.41	120.00	142.94
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb.	169.93	174.81	171.17
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb.	150.56	142.76	157.48
Choice Boxed Beef, 600-750 lb. Carcass.	205.72	209.99	232.55
Western Corn Belt Base Hog Price Carcass, Negotiated	72.35	57.94	66.39
Pork Carcass Cutout, 185 lb. Carcass 51-52% Lean.	81.93	74.69	76.63
Slaughter Lambs, wooled and shorn, 135-165 lb. National.	132.12	154.36	159.87
National Carcass Lamb Cutout FOB.	340.15	342.41	385.76
Crops, Daily Spot Prices			
Wheat, No. 1, H.W. Imperial, bu.	3.62	2.93	3.12
Corn, No. 2, Yellow **Columbus**, bu.	3.46	3.33	3.28
Soybeans, No. 1, Yellow **Columbus,** bu.	9.53	8.51	8.73
Grain Sorghum, No.2, Yellow Dorchester, cwt.	5.40	5.27	5.46
Oats, No. 2, Heavy Minneapolis, Mn, bu.	2.48	2.85	2.74
Feed			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton.	152.50	*	127.25
Alfalfa, Large Rounds, Good Platte Valley, ton.	*	65.00	72.50
Grass Hay, Large Rounds, Good Nebraska, ton.	85.00	67.50	65.00
Dried Distillers Grains, 10% Moisture Nebraska Average.	125.00	103.75	104.00
Wet Distillers Grains, 65-70% Moisture Nebraska Average.	46.00	42.50	41.00
*** No Market**			

A May 2017 decision by the Nebraska Court of Appeals deals with an unfortunately common situation in Nebraska family farm corporations– *is the on-farm heir (or heirs) in charge of the corporation legally required to share the corporation's income with the off-farm heirs?* (24 Neb. App. 649) As we shall see, the court answered "no" even though that seems to be an unfair result.

Four siblings–two brothers and two sisters–inherited the south-central Nebraska family farm. Each brother owned 42.875% of the farm corporation stock and each sister owned 7.125%. Mom had owned 28.5% of the stock which she divided equally among the four children in her will (7.125% each). Dad owned 71.5% of the stock which he left equally to his two sons in his will (35.75% each). The corporation rented its land to the two brothers on a 50-50 crop share lease. Whenever the farm corporation earned more than $50,000 net income, the brothers (who owned the majority of stock and thus controlled the corporation) would pay themselves enough commodity wages to bring the farm's net income to $50,000. In 2012-2013 the brothers received $394,200 in commodity wages (on which they paid personal income tax); the farm never paid a cash dividend and the sisters never received any income from the farm.

One sister sued the corporation in 2013. She had first offered to sell her stock to her brothers but they could not negotiate a selling price. The sister's lawsuit contended that the brothers paying all corporate income above $50,000 to themselves and refusing to pay any cash dividends (which all four siblings would have shared proportionally) was legally "oppressive" and violated the brother's fiduciary obligations to manage the corporation to benefit all the shareholders, not just themselves.

In court the brothers' justification for the commodity wages approach to keep the corporation's taxable income to no more than $50,000 was *that's how Dad did it*. At $50,000 the corporation paid taxes at the lowest federal corporate rate, 15%. Above $50,000 the corporation's tax rate would increase. So at the end of each year Dad (and later the brothers) would look for expenses to prepay, equipment to purchase, grain sales to defer, and other options to reduce the corporation's taxable income to $50,000. The father started this practice and the sons continued it. In especially high income years, the father would pay himself and his sons commodity wages to reduce the corporation's taxable income to $50,000. The sons continued this practice.

After the trial, the district court ruled that the commodity wage approach to reducing the corporation's income taxes was not legally oppressive, although the court also stated that continuation of that practice and refusing to pay dividends could become oppressive over time (24 Neb. App. at 661). The Court of Appeals acknowledged this in affirming the district court's opinion. A dissenting justice concluded that the failure to pay cash dividends even in years of high corporate income was oppressive. Only a few states follow this dissenting approach and several do not.

One important point I make to my agricultural law students in class every year is **even though something is legal, that doesn't necessarily make it right or fair or just**. This case is a good illustration of this point. The brothers' refusal to pay even a part of the corporate income in dividends was unfair to their sisters, rendering their ownership interest in the farm essentially worthless. Nebraska law does not require corporations to pay dividends on corporate profits but makes that discretionary with the corporate board of directors. Those directors are given wide latitude in how to manage corporate profits—whether to expand the business, purchase new equipment, pay employee bonuses, or pay a dividend. And it is not an all or nothing decision-–the board could decide to use some portion of corporate profits for one or more of these items. I tell my students that if off-farm heirs are not receiving regular payments from the farm operation (such as their share of land rents) the on-farm heirs are well advised to pay part of any significant farm income out as dividends (in years when the farm can afford to do so). This way, the off-farm heirs feel that they are sharing in the farm's profitability and are less likely to try to get out of the business. If the on-farm heirs vote to retain all the earnings for business expansion–or worse as in this case to pay themselves large commodity wage bonuses–they are just asking for trouble. While this minority shareholder freeze-out is a common tactic, it is unfair to those frozen-out, minority shareholders in my opinion.

J. David Aiken, Professor
Water & Agricultural Law Specialist
Department of Agricultural Economics
University of Nebraska-Lincoln
Lincoln NE 68583-0922
402-472-1848; daiken@unl.edu