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**Crop Share Arrangements and the Family  
Farm Corporation: Planning Needed  
for Tax-Free Separation of Business**

by

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# CROP SHARE ARRANGEMENTS AND THE FAMILY FARM CORPORATION: PLANNING NEEDED FOR TAX-FREE SEPARATION OF BUSINESS

*Scott E. Copple\**

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## I. INTRODUCTION

If it is true that you can choose your friends but not your relatives, it may also be true that if you operate a family farm or ranch business you cannot choose your business associates. When younger family members take over the family farm or ranch business, disagreements are not uncommon and the parties may decide to go their separate ways. Unfortunately, if the business is conducted through a family-owned corporation, the tax consequences of splitting up the family farm or ranch could be prohibitive.<sup>1</sup> A corporate separation could provide a tax-free means of separating the business interests of feuding shareholders.<sup>2</sup> However, the shareholders may be unable to separate their business interests without incurring a significant tax liability if part of the corporation's operations include leasing agricultural property.<sup>3</sup> This article examines the tax issues confronting the shareholders of a corporation leasing farm or ranch land when they plan for a separation of business interests.

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1. See *infra* Part III.

2. See *infra* Part III.

3. See *infra* Part III.

## II. BACKGROUND

The corporation has been utilized for decades as an effective business entity for operating a family farm or ranch.<sup>4</sup> In addition, the family farm corporation has been used as an estate planning tool, its stock providing an efficient vehicle for the transfer of ownership of the family business to younger family members.<sup>5</sup> However, effective estate planning does not ensure that younger family members will be compatible business associates after the transfer to them of the stock in the family corporation. The disagreements that may arise between shareholders in a family corporation can be severe. Unfortunately, the tax consequences of splitting up the family farm or ranch may be more severe. Family members are often faced with a "Hobson's Choice,"<sup>6</sup> choosing between continuing in an unpalatable business arrangement or incurring an onerous tax liability at the corporation and shareholder level.

Once the shareholders of a family-owned corporation determine that disagreements between them cannot be resolved and a separation of business interests is necessary, there are four transactions that will accomplish a separation of business interests: a corporate liquidation, a stock sale, a stock redemption, and a divisive corporate reorganization.<sup>7</sup> The divisive reorganization is the only transaction that holds any realistic hope of avoiding significant tax liability.<sup>8</sup>

A corporate liquidation is a fully taxable transaction to the corporation and its shareholders.<sup>9</sup> A corporation recognizes gain on the liquidating distribution of its assets in the same amount as if it had sold its assets for their fair market value.<sup>10</sup> Each shareholder recognizes gain based on the excess of the value of the assets received over the tax basis in his or her stock.<sup>11</sup> Although a corporate liquidation would accomplish the family's objective of separating their business interests; if the corporation's assets were appreciated in value, a significant tax liability could be incurred.<sup>12</sup> Likewise, substantially appreciated stock would cause the shareholders to incur a significant individual tax liability.<sup>13</sup> In the face of this significant tax

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4. See Kenneth D. Esch & Pamela L. Spaccarotella, *Limited Liability Companies as an Alternative Choice of Entity for Farming and Ranching Operation in Nebraska*, 28 CREIGHTON L. REV. 19, 30-31 (1994).

5. See *id.*

6. See WEBSTER'S NEW INTERNATIONAL DICTIONARY 1076 (3d ed. 1981) (defining Hobson's Choice as "[a]n apparent freedom of choice where there is no real alternative.").

7. See I.R.C. §§ 302, 331, 334, 336, 1001 (1994); I.R.C. §§ 355, 368 (1994 & Supp. III 1997).

8. See I.R.C. § 368(a)(1)(D) (1994).

9. See *id.* §§ 331, 336.

10. See *id.* § 336.

11. See *id.* § 1001.

12. See *id.*

13. See *id.*

liability, family members engaged in even the most rancorous of disputes might be compelled to seek an alternative transaction.

A straight sale of stock creates taxable gain only for the shareholder selling his or her stock.<sup>14</sup> Although a stock sale would, in theory, reduce the tax consequences of separating feuding shareholders, it may not be effective. The purchasing shareholder(s) may not have the personal financial wherewithal to buy the stock. Interest paid in connection with money borrowed to purchase the stock may not be deductible by the purchasing shareholders.<sup>15</sup> The inability of the purchasing shareholders to deduct any interest paid in connection with the purchase may cause the parties to structure the buy-out as a stock redemption.<sup>16</sup> If the redeemed shareholder completely terminates his or her interest in the corporation, it may be possible to treat the redemption as a sale of stock by the redeemed shareholder.<sup>17</sup> However, in a family corporation, certain stock ownership arrangements can effectively deny the taxpayers the opportunity to utilize a redemption transaction.<sup>18</sup>

The problem with a stock sale or a stock redemption for cash is that the selling shareholder never gets any of the corporation's agricultural land assets or equipment.<sup>19</sup> Unless the selling shareholder wants to get out of the farm or ranch business, these options are probably unacceptable.

The farm or ranch corporation could distribute land and equipment in the redemption of a shareholder's stock.<sup>20</sup> However, in addition to the gain recognized by the redeemed shareholder, the corporation will recognize gain on the distribution of appreciated property in the same amount as if it had sold the property for its fair market value.<sup>21</sup> If greatly appreciated land were distributed, a large taxable gain will be recognized by the corporation.<sup>22</sup>

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14. *See id.*

15. *See id.* § 163(d). Unless the corporation has elected to be treated as an S corporation, any interest paid by the purchasing shareholder would be treated as investment interest expense. *See id.* As such, the shareholder's tax deduction would be limited to the amount of investment income (generally, interest and dividend income) recognized by the shareholder. *See id.*

16. *See id.* § 302(a).

17. *See id.* § 302(b)(3).

18. *See id.* §§ 302(c)(2), 318(a)(1). Although a shareholder may waive the family stock attribution rules otherwise applicable in determining if a shareholder has completely terminated his or her interest in a corporation, there are certain requirements that must be met before a shareholder can avoid the family attribution rules. *See id.* §§ 302(c)(2)(A)(i)-(iii), 318(a)(1). In addition, the rules operating to attribute stock held by a trust to the trust beneficiaries apply even if the family attribution rules are waived. *See id.* §§ 302(c)(2), 318(a)(2)(B)(i). If a shareholder engaging in a stock redemption is a beneficiary of a trust owning stock in the corporation, these attribution rules could cause the redemption to be recast as a dividend distribution for tax purposes. *See id.* § 318(a)(2)(B)(ii).

19. *See id.* § 302(a).

20. *See id.* § 302(b)(4).

21. *See id.* § 311(b)(1).

22. *See id.*

The taxable gain recognized under all of the transactions just described could be avoided if the family-owned corporation is able to engage in a tax-free corporate division under section 368(a)(1)(D).<sup>23</sup> In a typical corporate division involving feuding shareholders, the corporation would transfer assets to a newly created subsidiary corporation ("Newco") in exchange for the newly created corporation's stock.<sup>24</sup> Following the transfer of assets to Newco, the original corporation would distribute its Newco stock to the disgruntled shareholder(s) in exchange for the shareholder(s)' stock in the original corporation.<sup>25</sup> A corporate separation described above is commonly referred to as a split-off.<sup>26</sup> A split-off would leave one shareholder or group of shareholders with one hundred percent ownership in the original corporation and another shareholder or group of shareholders with one hundred percent ownership in Newco.<sup>27</sup> The shareholders could accomplish their objective of separating their interests in the family farm or ranch and, if the requirements of section 368(a)(1)(D) were satisfied, they would do so without incurring a tax liability.<sup>28</sup>

### III. POTENTIAL PROBLEM FOR CORPORATIONS ENGAGED IN LEASING AGRICULTURAL LAND

The tax provisions affording a tax-free split-off are designed to allow the transfer of assets to a newly created subsidiary corporation and the subsequent distribution of the subsidiary's stock when a corporate business purpose exists for the transaction.<sup>29</sup> Serious shareholder disagreements that could negatively effect the efficient operation of the corporation's business have been recognized as valid business purposes for a tax-free split-off.<sup>30</sup>

In an effort to ensure that taxpayers do not avoid tax liability otherwise due on the distribution of property (including stock of a subsidiary) from a corporation, several requirements must be met before a taxpayer is allowed to receive stock in a subsidiary corporation pursuant to the tax-free corporate split-off provisions.<sup>31</sup> In

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23. See *id.* § 368(a)(1)(D).

24. See *id.*

25. See *id.*

26. See BORIS I. BITKER & JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 11.01(1)(e)(2) (6th ed. 1998).

27. For example, if A and B own X, Inc. and effect a corporate split-off, assets of X, Inc. would be transferred to Newco in exchange for Newco stock. Newco stock would be distributed to B in exchange for B's X, Inc. stock. X, Inc. would be owned by A, and Newco would be owned by B after the split-off.

28. See I.R.C. § 368(a)(1)(D) (1994).

29. See *Gregory v. Helvering*, 293 U.S. 465, 469 (1935), Treas. Reg. § 1.368-1(b) (1998).

30. See *Athanasios v. Commissioner*, 67 T.C.M. (RIA) 415, 416 (1995); Treas. Reg. § 1.355-2(b) (as amended in 1992).

31. See I.R.C. § 355 (1994 & Supp. III 1997); I.R.C. § 368(a)(1) (1994); Treas. Reg. § 1.368-1(b) (1998).

addition to the business purpose requirement mentioned above, the shareholders must be prepared to show that the other requirements in section 368(a)(1)(D) have been met.<sup>32</sup>

In a transaction such as the one described above, section 368(a)(1)(D) requires that after the transfer of assets to a newly created subsidiary corporation in exchange for Newco stock has been completed, the original corporation must distribute the Newco stock to its shareholders in a transaction qualifying under section 355.<sup>33</sup> In other words, if farm or ranch assets are transferred pursuant to a valid business purpose in exchange for Newco stock and the Newco stock is thereafter distributed to the shareholders of the original corporation, one must look to section 355 to determine if the transaction will qualify as a tax-free corporate split-off.<sup>34</sup>

Section 355 requires that after the distribution of the subsidiary stock, both corporations must be engaged in the active conduct of a trade or business.<sup>35</sup> In addition to the active conduct provision, the trade or business must have been actively conducted throughout a five-year period immediately prior to the distribution.<sup>36</sup> This five-year business history requirement does not demand that the corporation (the original corporation or Newco) conduct the business (otherwise a newly created subsidiary could never meet this requirement), but only that the business be conducted over a five-year period and the assets used in the business were not acquired in a taxable transaction.<sup>37</sup> In a typical corporate split-off, the assets of a business are acquired by the newly created subsidiary in a nontaxable transaction.<sup>38</sup>

A farm or ranch corporation actively operating its business on all its property should be able to utilize a tax-free corporate split-off to separate feuding shareholders.<sup>39</sup> However, in the case of a farm or ranch corporation leasing its agricultural land, a potential problem arises when the corporation attempts to divide corporate assets in connection with a proposed split-off. It is not uncommon for an agricultural corporation to operate its business on one or more parcels of land and to lease other land to unrelated tenant farmers or to shareholders that operate the leased ground independently from the corporation.<sup>40</sup> In a situation involving leased

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32. See I.R.C. § 368(a)(1)(D) (1994).

33. See *id.*

34. See *id.*

35. See *id.* § 355(b)(1)(A).

36. See *id.* § 355(b)(2)(B).

37. See *id.* § 355(b)(2). This requirement is designed to prevent a corporation from purchasing and distributing trade or business assets to a shareholder in a purported split-off that is, in substance, a taxable stock redemption. See *id.*

38. See *id.* § 355(a)(1)(B). See also §§ 351(f), 368(a)(1)(D).

39. See Roger A. McEowen, *Current Legal Issues Impacting Farm and Ranch Organizational Planning*, 28 U. TOL. L. REV. 697, 735 (1997).

40. See Esch & Spaccarotella, *supra* note 4, at 30-31.

property, it is often the desire of the shareholders to transfer the leased ground (and perhaps some equipment) to the newly created corporation with the intention that the departing shareholder(s) will operate the leased farm or ranch land as corporate officers or employees.<sup>41</sup>

This arrangement can create the potential for a fully taxable corporate separation if the Service determines that the property transferred to the newly created subsidiary (the leased land) has not been used in the active conduct of a trade or business.<sup>42</sup> The Service has held that leasing property generally does not constitute the active conduct of a trade or business.<sup>43</sup>

If the primary asset to be transferred to the newly-created corporation is land leased to tenant farmers or to a shareholder, the corporate split-off may be unable to meet the requirement that both corporations are engaged in an active trade of business with a five-year history.<sup>44</sup> A cash lease arrangement would almost certainly fail the active trade or business requirement.<sup>45</sup> According to treasury regulations, a corporation conducts an active business only when the corporation itself performs, "active and substantial management and operational functions."<sup>46</sup>

In the case of a farm or ranch corporation leasing property under a crop-share arrangement, the degree of involvement of the officers and employees of the original corporation in the management and operational functions relating to the leased property will determine whether the corporate split-off can be accomplished tax-free.<sup>47</sup> Fortunately, the Service has issued two revenue rulings that address this critical issue and provide guidance to agricultural corporations seeking to distribute leased land to a newly-created corporation in a corporate split-off.<sup>48</sup>

In Revenue Ruling 73-234, the taxpayer corporation ("X"), operated an insurance agency business and owned 100 % of the stock in another corporation ("Y") engaged in the business of farming.<sup>49</sup> The taxpayer intended to distribute the subsidiary stock to its sole shareholder (for valid business reasons) in a transaction qualifying as a tax-free corporation split-off.<sup>50</sup> The corporation requested a ruling from the Service regarding whether the farming operation conducted by the subsidiary corporation constituted an active trade or business under section 355<sup>51</sup>

The actual farming of the land owned by the subsidiary was done by tenant farmers who were compensated with a share of the proceeds from the sale of crops

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41. *See id.*
  42. *See Treas. Reg. § 1.355-3(b)(2)(iii) (1989).*
  43. *See id. § 1.355-3(b)(2)(iv)(B).*
  44. *See id. § 1.355-3(b)(3).*
  45. *See id.*
  46. *Id. § 1.355-3(b)(2)(iii).*
  47. *See Rev. Rul. 86-126, 1986-2 C.B. 59.*
  48. *See Rev. Rul. 73-234, 1973-1 C.B. 180.*
  49. *See id.*
  50. *See id.*
  51. *See id.*

and livestock.<sup>52</sup> The corporation employed a handyman ("B") to maintain the farm property and equipment.<sup>53</sup> The president and sole shareholder ("A") of the parent corporation was an experienced farmer.<sup>54</sup> A was employed by the subsidiary corporation to participate in the farming operation.<sup>55</sup> A, on behalf of Y, entered into agreements with various tenant farmers.<sup>56</sup> Y supplied all equipment and financing for Y's operation.<sup>57</sup> A devoted, in the Service's words, "significant time and effort to the farming business of Y."<sup>58</sup> A studied Federal agricultural programs, planned the planting and harvesting of crops, and purchased and planned the breeding of livestock.<sup>59</sup> A hired seasonal workers and was responsible for the sale of crops and livestock.<sup>60</sup>

The Service stated that the active business requirement in section 355 demands that the corporation itself as opposed to independent contractors carry on substantial management and operational activities.<sup>61</sup> The Service went on to state: "However, the fact that a portion of a corporation's business activities is performed by independent contractors will not preclude the corporation from being engaged in the active conduct of a trade or business if the corporation itself directly performs active and substantial management and operational functions."<sup>62</sup>

The Service held that activities conducted by Y, through its employees, constituted "substantial management and operational functions apart from those activities performed by tenant farmers," and that Y satisfied the active business requirement of section 355.<sup>63</sup>

In Revenue Ruling 86-126, the Service held that the taxpayer, a corporation, did not engage in substantial operational and managerial activities with respect to farmland leased to tenant farmers.<sup>64</sup> Consequently, the taxpayer could not satisfy the active business requirement in section 355 of the I.R.C.<sup>65</sup>

In Revenue Ruling 86-126, the corporation had sought to transfer one-half of its property to a newly created subsidiary, followed by the distribution of the subsidiary stock to one of the corporation's shareholders.<sup>66</sup> The corporation, owned

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| 52. | <i>See id.</i>                                    |
| 53. | <i>See id.</i>                                    |
| 54. | <i>See id.</i>                                    |
| 55. | <i>See id.</i>                                    |
| 56. | <i>See id.</i>                                    |
| 57. | <i>See id.</i>                                    |
| 58. | <i>Id.</i>  |
| 59. | <i>See id.</i>                                    |
| 60. | <i>See id.</i>                                    |
| 61. | <i>See id.</i> at 181; I.R.C. § 355(b)(2) (1994). |
| 62. | Rev. Rul. 73-234, 1973-1 C.B. 181.                |
| 63. | <i>Id.</i>  |
| 64. | <i>See</i> Rev. Rul. 86-126, 1986-2 C.B. 59.      |
| 65. | <i>See id.</i>                                    |
| 66. | <i>See id.</i>                                    |

equally by A and B, held large tracts of farmland.<sup>67</sup> A and B were independent farmers who farmed their own land and served as officers of the corporation.<sup>68</sup> The corporate farmland was leased to tenant farmers under an arrangement where all income and expenses of the farm were shared equally.<sup>69</sup> The tenant farmers under the agreement were responsible for obtaining financing necessary for their share of farming expenses.<sup>70</sup> The planting, raising, and harvesting of crops was completed solely by the tenant farmers.<sup>71</sup> The tenant farmers were required to supply the equipment used in farming the corporation's land and maintained the equipment and irrigation system.<sup>72</sup> A and B consulted with the tenant farmers regarding herbicides, insecticides, and fertilizer which the tenant farmers purchased.<sup>73</sup> The tenant farmers, after consulting with A and B, contracted to sell the crops and provided an accounting of the proceeds to the corporation.<sup>74</sup>

A and B, in their capacities as officers of the corporation, periodically inspected the crops and improvements located on the leased land.<sup>75</sup> A and B notified the tenant farmer of any problems noticed, and the tenant farmer corrected the problems noted.<sup>76</sup> A and B decided what portion of the corporation's land to lease, considering soil conservation needs, market conditions, and federal price support and acreage reserve programs.<sup>77</sup> A and B reviewed each tenant's accounting of operations and sales.<sup>78</sup>

The Service distinguished the activities of the taxpayer in Revenue Ruling 86-126 from those of the taxpayer in Revenue Ruling 73-234 by concluding that the active business requirement was not met.<sup>79</sup> The Service stated:

However, in [Revenue Ruling 73-234], Y corporation, through its employees, A and B, was engaged in hiring seasonal workers, purchasing and supplying equipment, maintaining equipment, arranging financing, planning all rotation and planting and harvesting of crops, purchasing livestock, planning livestock breeding, selling all crops and livestock, and accounting to the tenant farmers for their shares of the proceeds. This activity of Y, carried on through its own employees and constituting active and substantial managerial and operational activity, contrasts with the activity carried on by the employees of P in the present situation. Here, P

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67. *See id.* at 58.  
68. *See id.*  
69. *See id.*  
70. *See id.*  
71. *See id.*  
72. *See id.*  
73. *See id.*  
74. *See id.*  
75. *See id.*  
76. *See id.* at 59.  
77. *See id.*  
78. *See id.* at 58.  
79. *See id.* at 59.

either did not engage in the above activities at all, or engaged in them only on a limited basis. At best, P could be considered to engage in some managerial and operational activity but not enough to 'qualitatively distinguish its operations from mere investments.'<sup>80</sup>

As the two revenue rulings just discussed suggest, merely leasing agricultural land under a crop-share arrangement will not be treated as an active business within the meaning of section 355<sup>81</sup>. It also appears that a corporation leasing agricultural land will have to demonstrate more than a moderate degree of involvement in the managerial decisions relating to the farm or ranch activity.<sup>82</sup>

In Revenue Ruling 86-126, the corporation, through its officers, occasionally inspected the farmland and decided which parcels of land to lease each year.<sup>83</sup> The corporation also consulted with the tenant farmers regarding herbicides, insecticides, and fertilizer, as well as when to sell the crops.<sup>84</sup> According to the Service, this activity is not enough to meet the "substantial managerial and operational activities" standard set forth in Revenue Ruling 73-234.<sup>85</sup> The Service found that the following factors set forth in Revenue Ruling 73-234 were lacking in Revenue Ruling 86-126:

- (1) hiring seasonal workers;
- (2) supplying and maintaining equipment;
- (3) arranging financing;
- (4) planning crop rotation, planting and harvesting;
- (5) selling crops; and
- (6) accounting to the tenant farmers.<sup>86</sup>

The Service held that it was the lack of these factors which distinguished the two rulings from each other.<sup>87</sup>

Whether the taxpayer in Revenue Ruling 86-126 was any less involved in planning crop rotation and planting than the taxpayer in Revenue Ruling 73-234 is unclear.<sup>88</sup> In Revenue Ruling 86-126, the taxpayer took into consideration the soil conservation needs of the land, as well as market conditions and federal programs in

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80. *Id.*  
81. *See id.*; Rev. Rul. 73-234, 1973-1 C.B. 181.  
82. *See* Rev. Rul. 86-126, 1986-2 C.B. 59.  
83. *See id.* at 58-59.  
84. *See id.* at 58.  
85. *Id.* at 59.  
86. *See id.*  
87. *See id.*  
88. *See id.*

determining which parcels to lease.<sup>89</sup> The degree of involvement in planning crop rotation and planting by the taxpayers in the two rulings is not addressed.<sup>90</sup>

#### IV. CORPORATIONS LEASING AGRICULTURAL LAND NEED TO PLAN FOR POSSIBLE BUSINESS SEPARATION

For taxpayers planning a corporate division of a family farm, addressing the factors listed in Revenue Ruling 86-126 will be crucial in attempting to satisfy the Service's interpretation of the active business requirement in section 355.<sup>91</sup> Fortunately, with the exception of the fact that the taxpayer in Revenue Ruling 73-234 supplied the machinery and equipment, the remaining factors the Service deemed relevant can be controlled by the taxpayer relatively easily.

One of the factors cited by the Service is the financing of the farming (or ranching) operation.<sup>92</sup> A corporation engaged in a crop-share arrangement with tenant farmers should structure the arrangement so that the corporation provides financing. Security agreements, letters of credit, and loan guarantees could be used to provide the corporation a fairly high level of assurance that the tenant farmer will ultimately pay his or her share of the expense associated with operating the farm.

Hiring seasonal workers was another factor the Service cited in distinguishing Revenue Ruling 72-234 from Revenue Ruling 86-126.<sup>93</sup> Corporations contemplating a corporate split-off should attempt to hire seasonal workers, or at least be involved in the selection of seasonal workers.

The selling of crops and accounting for the proceeds should be done by the corporation rather than the tenant farmers. The Service apparently distinguishes an enterprise meeting the active trade or business requirement in section 355 from an enterprise falling short of that requirement at least in part by who sells the product and who does the accounting.<sup>94</sup> One might question the importance that should be attached to these factors, but a corporation engaged in farming under a crop-share arrangement should contract to sell the crops produced. According to the Service, consultation with the tenant farmer regarding if and when to sell the crop is acceptable, but the actual sale of the crops should be done by the corporation to strengthen the corporation's claim that its farming business is "actively" conducted.<sup>95</sup> For the same reason, the responsibility of accounting for the operation should be borne by the corporation rather than the tenant farmer.

Supplying and maintaining equipment used in the farm or ranch operation is a factor considered by the Service to be relevant in assessing the taxpayer's level of

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89. *See id.* at 59.

90. *See id.*; Rev. Rul. 73-234, 1973-1 C.B. 181.

91. *See* Rev. Rul. 86-126, 1986-2 C.B. 59.

92. *See id.*

93. *See id.*

94. *See id.*

95. *See id.*

involvement in the business activity.<sup>96</sup> Unlike the question of who provides the accounting or who actually sells the crops, the question of who provides the equipment is not one to which the answer is easily manipulated. The decision to purchase or lease agricultural equipment is not usually based on a desire to satisfy the complex rules relating to corporate separations.

It is unclear whether failing to use the corporation's equipment is an insurmountable obstacle on the path to a tax-free corporate split-off. Revenue Ruling 86-126 does not single out the use of the corporation's own equipment as the critical or deciding factor in the determination of whether the corporation is carrying on "substantial operational and managerial activities."<sup>97</sup> It is simply one of several factors used to distinguish Revenue Ruling 73-234 from Revenue Ruling 86-126.<sup>98</sup>

On the other hand, common sense suggests that in a business dependent on the use of significant machinery and equipment, using one's own equipment (or leased equipment) would be an important factor in assessing the level of involvement in the operational activities of the business. However, the relatively recent popularity of the use of third parties in harvesting crops by farmers who are unquestionably substantially involved in the management and operational activities of the farm may render this factor less important than it has been previously.<sup>99</sup>

In any event, a corporation contemplating a separation of its business should consider structuring its crop share agreements to make use of its farm equipment on the leased ground. A corporation without equipment or one that is unable to use its equipment in a crop-share arrangement should attempt to structure the arrangement so that all the other factors listed in Revenue Ruling 73-234 are met.<sup>100</sup>

## V. CONCLUSION

When circumstances dictate that ownership of the family farm or ranch business must be separated, and the business is conducted as a corporation, the tax costs can be prohibitive. Liquidating the corporation could be the most costly solution, requiring the corporation to recognize gain on any appreciated property and the shareholders to recognize gain inherent in their stock.<sup>101</sup> A stock sale or stock redemption would cause gain to be recognized by the selling shareholder(s), without a taxable distribution of corporate property, and would not split up the farm or ranch property held by the corporation.<sup>102</sup> A stock redemption could be required to be

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96. *See id.*

97. *Id.*

98. *See id.*

99. *See id.*

100. *See* Rev. Rul. 73-234, 1973-1 C.B. 180 (setting forth factors needed to meet substantial managerial and operational activities).

101. *See supra* Part II.

102. *See supra* Part II.

recast as a dividend distribution if the redeemed shareholder continued to hold an indirect ownership interest in the corporation through the complex stock attribution rules.<sup>103</sup>

A separation of business interests through a corporate split-off pursuant to sections 368 and 355 of the I.R.C. is the only tax-free method of separating a corporation's business.<sup>104</sup> One of the prerequisites of a tax-free corporate split-off is that after the split-off each corporation must operate an active business with a five-year history.<sup>105</sup> In the case of a corporation proposing to separate leased land from land used by the corporation in its farm or ranch operations there is a risk that the corporation holding the land leased to tenant farmers or shareholders could fail the active business test.<sup>106</sup> Taxpayers should attempt to structure their crop-share lease arrangements to include those factors set forth by the Service in revenue rulings giving guidance regarding the level of participation needed to meet the active trade or business test required before a split-off will be given tax-free status.

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103. See *supra* Part II.

104. See, e.g., I.R.C. § 355, (1994 & Supp. III 1997); I.R.C. § 368(a)(1) (1994).

105. See I.R.C. § 355(a)(3)(B) (1994).

106. See *infra* Part III.