

Incorporation, the little used tool in estate planning

BY SHEILA MILLER

LITITZ — The corporation — an estate planning tool scarcely used by family farms — is the subject of this week's final article in the series on estate planning.

Until recently, there were few farmers in the Commonwealth who used this tool in handling their estates, primarily because of the tax implications of incorporation.

But this may all change in the near future if House Bill 1606 is passed by the Senate and signed by the Governor.

Introduced this year by Lancaster County's Noah Wenger, this bill would exempt the family farm from paying the annual one percent tax on the assets of the corporation.

This would be an incentive to farmers because now they would not be saddled with the across-the-board tax if their income didn't justify it.

To understand just what an impact the tool of incorporation can have on handling an estate, let's take a look at just what incorporation means.

According to Penn State's circular 552, Incorporate Your Farm?, a corporation is "a 'person' created by the state of Pennsylvania. It has most of the legal rights and duties of any other person and can own property, sue or be sued, borrow money, and perform other acts of business."

They point out that the people who own the corporation are completely separate and apart from the 'person' of the corporation.

To understand this a little better, let's look at the example of a farm couple we'll call Mr. and Mrs. Smith.



The Smiths decided to incorporate their farm several years ago. And, after many years of service, their old manure spreader was about shot.

When the Smiths, acting as agents of the corporation went out and bought a new manure spreader, they were not individually responsible for paying for the new piece of equipment—the corporation was responsible.

Jesse Cooper, a farm management specialist from Penn State, points out a corporation is owned by the stockholders, which can range in number from one to many.

In a farm situation, these

stockholders are generally the family members, but they may include other people who have an investment in the business.

Stockholders own shares, or stocks, in the corporation, and at least once a year they meet to elect their board of directors. The directors usually are the business managers, although they may employ a general manager.

The corporation then hires employees to help see the business gets carried out. When looking at a family farm, this chain of command from directors to stockholders to employees is usually the family members.

Even though an incorporated farm is a closely knit business, Penn State warns that some of the legal formalities must be followed or the courts could decide the incorporation was merely a scheme to defraud the government and could refuse to recognize it.

Incorporation gives the farm family the means of making money through paid wages, dividends, principal payments, lease payments, retirement plans, and the sale of stock, Cooper said.

Other reasons for incorporating the farm, Cooper said, include the factor of limited liability.

Unlike a partnership, a stockholder in a corporation is not liable for the debts of the corporation. No creditor of an incorporated farm can seek payments from the farm's individual stockholders.

What happens if a corporation goes bankrupt? The stockholders lose the money, time, and effort they've invested in the business—nothing more unless the stockholder has signed papers obligating personal assets.

Cooper pointed out that although most corporations borrow money, in a farm situation, most commercial lenders consider an incorporated farm loan as a loan to a sole proprietor. He said that is because most farms don't sell bonds or stocks.

Another reason for incorporating, Cooper said, is the easy transfer of property between individuals. Shares in a farm can be given away or sold.

When settling an estate of one of the corporation's stockholders, the shares

owned by the decedent are transferred and the corporation continues. Whereas in a partnership, on the death of one of the partners, the agreement dissolves.

One drawback in using incorporation as an estate

planning tool is that usually a farm business cannot pay large dividends to its stockholders. Therefore, if parents leave shares of stock to a child when settling an

(Turn to Page B4)

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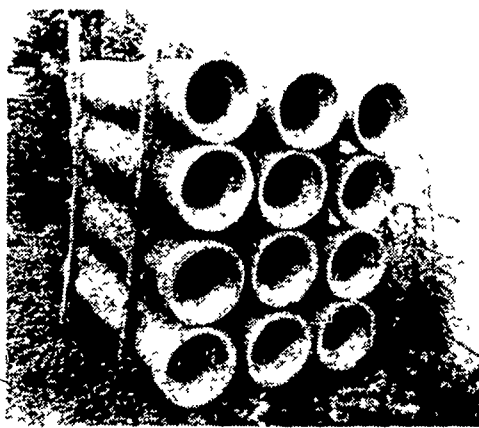
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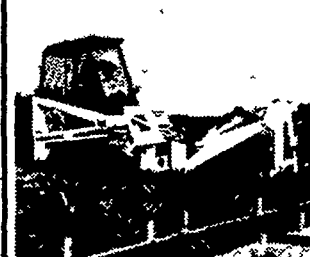
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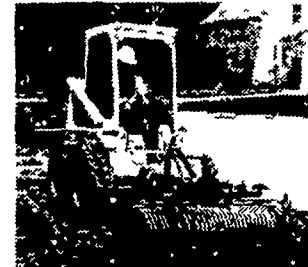
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