Characteristics and Legal Requirements for the Various Forms of Business Organization Available to Alabama Farmers
Characteristics and Legal Requirements for the Various Forms of Business Organization Available to Alabama Farmers*

SIDNEY C. BELL and N. CECIL DORSEY, JR. **

INTRODUCTION

THE PARTIES INVOLVED in a farm business are free to choose the form of organization under which the business will operate. Unfortunately, there is no "cut and dried" solution to the problem of choosing the proper form of farm business organization. Each farm business is unique and should be individually analyzed before a form of organization is selected.

The most common form of business organization in American agriculture is the sole proprietorship. This is a logical choice since most farms are one-owner, one-manager operations. Another factor contributing to the popularity of the sole proprietorship is that fewer government regulations are imposed on the sole proprietorship than on any other form of business organization.

The partnership and the corporation are alternative forms of business organization used by farmers, but these are not as widely used as the sole proprietorship. When two or more individuals are involved in the ownership and/or management of a business, the partnership and corporation are valid alternatives to the sole proprietorship. A partnership may consist of both general and/or limited partnership agreements. The corporate form of business organization may be subdivided into the general corporation and the Subchapter S (tax option) corporation.

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**Professor and former Graduate Research Assistant, Department of Agricultural Economics and Rural Sociology.
<table>
<thead>
<tr>
<th>Region and organizations</th>
<th>1974</th>
<th>1978</th>
<th>Percent change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>No.</td>
<td>Pct.</td>
</tr>
<tr>
<td>West Region²</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sole proprietorships</td>
<td>153,552</td>
<td>162,649</td>
<td>5.9</td>
</tr>
<tr>
<td>Partnerships</td>
<td>17,866</td>
<td>25,975</td>
<td>45.4</td>
</tr>
<tr>
<td>Corporations</td>
<td>9,077</td>
<td>13,801</td>
<td>52.0</td>
</tr>
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<td>South Region³</td>
<td></td>
<td></td>
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<tr>
<td>Sole proprietorships</td>
<td>509,275</td>
<td>589,525</td>
<td>15.8</td>
</tr>
<tr>
<td>Partnerships</td>
<td>44,732</td>
<td>74,815</td>
<td>67.3</td>
</tr>
<tr>
<td>Corporations</td>
<td>8,499</td>
<td>17,075</td>
<td>100.9</td>
</tr>
<tr>
<td>Other⁴</td>
<td>1,471</td>
<td>2,854</td>
<td>94.0</td>
</tr>
<tr>
<td>North Central Region⁵</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Sole proprietorships</td>
<td>772,604</td>
<td>755,720</td>
<td>2.2</td>
</tr>
<tr>
<td>Partnerships</td>
<td>75,366</td>
<td>98,514</td>
<td>30.7</td>
</tr>
<tr>
<td>Corporations</td>
<td>8,465</td>
<td>17,352</td>
<td>105.0</td>
</tr>
<tr>
<td>Other⁴</td>
<td>1,494</td>
<td>2,084</td>
<td>39.5</td>
</tr>
<tr>
<td>Northeast Region⁶</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sole proprietorships</td>
<td>82,142</td>
<td>90,503</td>
<td>10.2</td>
</tr>
<tr>
<td>Partnerships</td>
<td>7,055</td>
<td>10,198</td>
<td>44.5</td>
</tr>
<tr>
<td>Corporations</td>
<td>2,615</td>
<td>3,714</td>
<td>42.0</td>
</tr>
<tr>
<td>Other⁴</td>
<td>181</td>
<td>296</td>
<td>63.5</td>
</tr>
<tr>
<td>Total for United States</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sole proprietorships</td>
<td>1,517,573</td>
<td>1,598,397</td>
<td>5.3</td>
</tr>
<tr>
<td>Partnerships</td>
<td>144,969</td>
<td>209,502</td>
<td>44.5</td>
</tr>
<tr>
<td>Corporations</td>
<td>28,656</td>
<td>51,942</td>
<td>81.3</td>
</tr>
<tr>
<td>Other⁴</td>
<td>3,849</td>
<td>6,475</td>
<td>68.2</td>
</tr>
</tbody>
</table>

¹Farms with annual sales of $2,500 and over.

²West Region includes the states of Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin.

³South Region includes the states of Alabama, Arkansas, Delaware, District of Columbia, Florida, Georgia, Kentucky, South Carolina, Tennessee, Texas, Virginia, and West Virginia.

⁴This includes cooperatives, estates or trusts, and institutional firms.


The objectives of both the business entity and the owner(s) should be carefully considered when choosing the organizational structure of the farm business. Some of the objectives to be considered are estate planning, business management, liability, anticipated duration of the business, and income tax management. A form of business organization that facilitates the estate planning objectives may not be the best form of business organization to accomplish the day-to-day operation of the business.

The objectives of a business are intertwined; therefore, all objectives must be considered when choosing the basic form of business organization. If this is not done, the form of business organization chosen may not accomplish the objectives of the owners.

Since the choice of a business organization's structure is limited from a legal standpoint, it is impossible to develop a form of business organization that will precisely fit the needs and objectives of each farm business. However, the existing forms of business organization can be considerably modified to meet individual needs. The services of an attorney and/or a certified public accountant can be invaluable in modifying a business organization to best achieve the objectives of the business entity and the owner(s).

Several changes are taking place in the agricultural sector. Farm businesses are getting larger, including more multiple-person operations, and becoming more highly capitalized. This makes it more difficult to begin a farming operation and, should the occasion arise, to liquidate the farming operation. Thus, more attention is being given to the perpetual continuity of the farming operation. These changes are encouraging the use of partnership and corporate forms of organization in agriculture.

The number of sole proprietorships in the United States' agricultural sector increased by only 5.5 percent from 1974 to 1978, table 1. Between those years, the number of partnerships and corporations increased 44.5 percent and 81.3 percent, respectively. In some regions of the United States, the number of farm corporations increased as much as 105 percent during this period.

The number of farm firms in Alabama organized as partnerships and corporations increased by 72.5 percent and 111.5 percent, respectively, between 1974 and 1978, table 2. During this time, the number of Alabama farms organized as sole proprietorships increased by only 13.3 percent.
**Table 2. Number of Farms by Type of Business Organization, Alabama, 1974 and 1978**

<table>
<thead>
<tr>
<th>Type of organization</th>
<th>1974</th>
<th>1978</th>
<th>Percent change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>No.</td>
<td>Pct.</td>
</tr>
<tr>
<td>Sole proprietorships</td>
<td>27,007</td>
<td>30,590</td>
<td>13.3</td>
</tr>
<tr>
<td>Partnerships</td>
<td>1,927</td>
<td>3,324</td>
<td>72.5</td>
</tr>
<tr>
<td>Corporations</td>
<td>279</td>
<td>590</td>
<td>111.5</td>
</tr>
<tr>
<td>Other2</td>
<td>56</td>
<td>77</td>
<td>37.5</td>
</tr>
</tbody>
</table>

1 Farms with sales of $2,500 and over annually.
2 This includes cooperatives, estates or trusts, and institutional firms.


During 1974 to 1978, 37 Alabama counties showed a 100 percent or greater increase in the number of farm firms organized as corporations and 25 counties showed a 100 percent or greater increase in farm firms organized as partnerships.

**Characteristics and Legal Requirements of the Various Forms of Business Organization**

The three basic forms of business organization are the sole proprietorship, the partnership, and the corporation. A partnership may consist of both general and/or limited partnership agreements. The corporate form of business organization may be subdivided into the regular corporation and the Subchapter S (tax option) corporation. The major characteristics of the various forms of business organization are summarized in table 3.

**Sole Proprietorship**

The sole proprietorship is a form of business organization in which one individual (the owner) owns or controls all equity interest in the business, receives all business income, absorbs all business losses, and assumes full liability for all obligations of the business. It is the oldest and most common form of business organization used. Although the sole proprietorship organization should be considered in the selection of a form of business organization, it may represent an absence of organization. This may be attributed to the ease of formation, day-to-day operation, and dissolution of the business.
### Table 3. Characteristics of the Various Forms of Business Organization

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Sole proprietorship</th>
<th>Partnership General</th>
<th>Partnership Limited</th>
<th>Corporation Regular</th>
<th>Corporation Subchapter S</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formalities of organization</strong></td>
<td>No formalities,</td>
<td>Partnership agreement not required by law.</td>
<td>Partnership agreement must be written and recorded.</td>
<td>Incorporators may reserve a corporate name and adopt a preincorporation agreement. Articles of incorporation must be filed and recorded. Corporation issues stock in exchange for money or other assets. Shareholders adopt bylaws and elect directors. Directors elect officers.</td>
<td><strong>continued</strong></td>
</tr>
<tr>
<td><strong>Liability</strong></td>
<td>All assets of the proprietor may be required for obligations of the business.</td>
<td>Total assets of all partners may be required for obligations of the business and for actions of partners and employees.</td>
<td>Liability of limited partners is limited to amount they invest in partnership. Liability of general partners is same as for general partnership.</td>
<td>Total liability is limited to the assets of the corporation. Liability of each shareholder is limited to amount of investment in corporation unless personal guarantee is made for certain obligations of the corporation.</td>
<td><strong>continued</strong></td>
</tr>
<tr>
<td><strong>Business entity</strong></td>
<td>One person, business has no entity apart from the individual owners.</td>
<td>Two or more persons.</td>
<td>At least one limited partner and one general partner.</td>
<td>One person may incorporate a business in Alabama. Corporation has a separate legal entity with a distinct existence from that of its shareholders.</td>
<td><strong>continued</strong></td>
</tr>
<tr>
<td><strong>Business continuity</strong></td>
<td>Parallel to life span of the sole proprietor.</td>
<td>Agreed-on terms or can be dissolved by any partner. Usually associated with life cycle of the partners, but doesn't have to be.</td>
<td>Agreed-on terms or can be terminated by death or withdrawal of general partner. Not usually affected by death or withdrawal of limited partner.</td>
<td>Continuity is not associated with life cycle of individual shareholders. The period of duration may be limited to a specified time period or be perpetual. May be terminated by legal action.</td>
<td><strong>continued</strong></td>
</tr>
<tr>
<td>Characteristic</td>
<td>Sole proprietorship</td>
<td>Partnership General</td>
<td>Partnership Limited</td>
<td>Corporation Regular</td>
<td>Corporation Subchapter S</td>
</tr>
<tr>
<td>------------------------</td>
<td>---------------------</td>
<td>---------------------</td>
<td>---------------------</td>
<td>---------------------</td>
<td>-------------------------</td>
</tr>
<tr>
<td>Credit acquisition</td>
<td>Limited to equity of sole proprietor. Primary source is capital from retained earnings diverted from family living.</td>
<td>Limited to equity of partners. New capital obtained from retained earnings and equity of new partners admitted into partnership.</td>
<td>Equity of general partners. Specifically designed to attract capital from limited partners who do not participate in management.</td>
<td>From issuing shares of stock in exchange for money or other assets from retained corporate earnings. Limited to equity of corporation unless a shareholder personally guarantees a loan.</td>
<td>From issuing only one class of stock in exchange for money or other assets to 25 or fewer people and from retained earnings. Limited to equity of corporation unless shareholder personally guarantees a loan.</td>
</tr>
<tr>
<td>Federal income taxation</td>
<td>Based on individual income. Primary source is capital from retained earnings diverted from family living.</td>
<td>Partnership pays no tax but files informational tax return. Each partner reports income or loss on individual return.</td>
<td>Same as general partnership.</td>
<td>Corporation pays tax on taxable income after salaries to shareholder-employees have been deducted. Each shareholder reports dividends received and is taxed as an individual. This results in double taxation.</td>
<td>Corporation pays no tax but files informational return. Each shareholder's portion of income or operating loss, long term capital gains, and investment credit is reported on an individual return.</td>
</tr>
<tr>
<td>State income taxation</td>
<td>Based on individual income.</td>
<td>Partnership pays no tax but files informational tax return. Each partner reports income or loss on individual return.</td>
<td>Same as general partnership.</td>
<td>Corporation pays tax amounting to 5 percent of the net income annually. Deduction for federal income tax paid or accrued is allowed.</td>
<td>continued</td>
</tr>
<tr>
<td>Characteristic</td>
<td>Sole proprietorship</td>
<td>Partnership General</td>
<td>Limited</td>
<td>Corporation Regular</td>
<td>Subchapter S</td>
</tr>
<tr>
<td>--------------------------</td>
<td>---------------------</td>
<td>---------------------</td>
<td>---------</td>
<td>---------------------</td>
<td>--------------</td>
</tr>
<tr>
<td>Transferability of interest</td>
<td>Terminates ownership.</td>
<td>Partner may transfer interest to third party, but transferee is only entitled to assigning partner's share of profit. Cannot participate in management or require information regarding partnership transactions.</td>
<td>General partners same as for general partnership. A limited partner's interest is assignable at will.</td>
<td>Shareholders may transfer stock at will. Corporation may adopt stock transfer restrictions which give the corporation or existing shareholders the first option to purchase another shareholder's stock.</td>
<td></td>
</tr>
<tr>
<td>Management and control</td>
<td>Limited by capacity and resources of sole proprietor.</td>
<td>Partners generally share management equally. Each can legally bind partnership, thus requiring high level of confidence.</td>
<td>General partners same as for general partnership. If limited partners participate in management or operation of the partnership, they lose limited partner status.</td>
<td>Ultimate power rests with stockholders who elect board of directors. One vote per share of stock for each director to be elected. Cumulative voting may be allowed. Officers elected by board of directors.</td>
<td></td>
</tr>
</tbody>
</table>
**Formalities of Organization**

Most farm businesses in Alabama are sole proprietorships, perhaps because this is the easiest form of business organization to begin or end and is subject to fewer government regulations than any other. The sole proprietorship holds all rights in the business except those reserved for society, such as eminent domain and police power. The sole proprietorship can have the most flexible purposes for its business operations and needs no government approval except for certain activities ruled by government regulations, such as applying restricted pesticides. The organization of a sole proprietorship does not involve any formalities or expenses of organization.

**Liability**

Since the sole proprietorship is the oldest and most widely used legal business structure, the relationships between a sole proprietor and his agents, creditors, and other business cohorts are usually well known.

A sole proprietor is personally liable for any and all obligations of the business. The non-separation of personal and business assets in a sole proprietorship is especially significant when an accident in the farming operation occurs for which the sole proprietor is legally responsible. Personal assets that are completely unrelated to the farm business could be required to pay damages caused by the accident. Likewise, the farm assets of a sole proprietor may be acquired by someone to whom the sole proprietor is liable for a nonfarm-related accident. A sole proprietor's existing liabilities continue even after dissolution or sale of the farm business.

**Business Entity**

A sole proprietorship has no entity apart from the individual owner. Even though a sole proprietorship can be conducted under an assumed or fictitious name, the title or name under which the sole proprietor is trading is only descriptive. The sole proprietor and the business, regardless of its title, are one and the same.

There is no separation of a farmer's personal assets and business assets in a sole proprietorship. Therefore, a creditor with a claim against a farm business organized as a sole proprietorship can legally force payment from the sole proprietor's personal assets if
the assets of the farm business are inadequate to meet the business claim. Likewise, the assets may be required to pay off personal debts incurred by the sole proprietor.

**Business Continuity**

Sole proprietorships have no legal time limit but are not perpetual in nature. The life span of the sole proprietorship is usually parallel to the life span of the sole proprietor. However, where the business is directly dependent on the sole proprietor's personal attention and supervision, provisions can be made in the sole proprietor's will for the temporary operation of the business by the sole proprietor's appointed personal representative until the business can be sold or liquidated. If the authority to incorporate the business is not specifically provided by legal statute, authority to incorporate should be included in the sole proprietor's will.

**Transferability of Interest**

A sole proprietor's business is transferable at will. A sole proprietor has complete freedom to transfer or sell all or part of his business interest as he sees fit. However, the sale or transfer of all or part of the sole proprietor's interest in the farm business terminates the sole proprietorship. If the sole proprietor transfers all of his interest in the farm business, the new owner or owners of the business may choose any form of business organization. However, if the sole proprietor retains part interest in the farm business, the business can no longer operate as a sole proprietorship because two or more separate parties are involved. The sole proprietor is subject to restrictions on property transfers or business interest transfers imposed by law. In Alabama, a joinder by the sole proprietor's spouse is required in a conveyance of real estate.

**Management and Control**

A sole proprietorship has no formalities regarding management. The sole proprietor makes all the management decisions and is not subject to the disadvantages inherent in other types of business organization where other business associates may adopt business policies not agreeable to him.

One major attraction of the sole proprietorship is its degree of management flexibility. The owner may quickly expand or con-
tract the size of the business and add or eliminate enterprises at will. Theoretically, the sole proprietor can make a decision and implement it much more quickly than when several individuals are involved in the decision making process. However, this does not always work in practice because the sole proprietor may put off a difficult decision rather than make it. Quick but thoroughly weighed decisions are an important key to profitable management.

Credit Acquisition

There is no minimum capital statutory requirement for a sole proprietorship. Capital for operation of the business and/or investment can be obtained by borrowing, purchasing on credit, or by investing profits derived from the farm business. The sole proprietor is responsible for acquiring the capital needs of the farm business and is liable for all the debts and obligations of the farming operation. The capital and credit of a sole proprietorship are limited by the individual resources of the sole proprietor. The sole proprietor generally combines his own capital, labor, and management capabilities to operate the farm business.

General Partnership

A general partnership is an association of two or more persons to carry on as coowners of a business for a profit (I). Unless otherwise specified, each partner in a general partnership has an equal right to participate in management and deal with third parties. A majority of the partners controls the business decisions of the partnership. The property used in the partnership does not have to be coowned, but the partnership as a business enterprise must be owned by all the partners. The partnership may own none, some, or all of the property used in the business.

Where two or more people are involved, a general partnership is the easiest form of business organization to form and dissolve. A general partnership can have the same flexible purposes for its operations as a sole proprietorship, and generally needs no government approval. The legal and recordkeeping requirements for a general partnership are far less than for a limited partnership or a corporation. The general partnership form of business organization provides many young persons who cannot begin a farming operation on their own an opportunity to gain experience and to eventually have a farm business of their own.
Formalities of Organization

A general partnership may be organized with little or no expense or formality. A general partnership can be created by an oral agreement. However, a thorough, written partnership agreement is the best insurance against later misunderstandings that might occur between the partners. Therefore, it is advisable that a written partnership agreement be drawn up.

A partnership agreement should define the rights and duties of each partner. Such an agreement usually contains the date, the partnership name, the name of the partners, the purpose of the partnership business, the location of the business, the duration of the partnership, the initial capital contributions by each partner, how profits and losses are to be shared, each partner's rights and obligations in connection with management of the partnership, and provisions for termination or dissolution of the partnership.

Although it is not required by law, having the partnership agreement drawn up by an attorney at law, properly filed, and recorded at the appropriate county courthouse will assure that legal technicalities are met.

Liability

Each general partner has the power to act for the partnership so long as the action taken is within the scope of the business. A partner who conducts the business of the partnership in its usual manner binds the partnership even though the partner conducting the business of the partnership may be expressly prohibited from carrying on such business by the partnership agreement. This is true unless the person with whom the partner was dealing knew that the partner was acting without proper authority (2).

General partners are personally liable for all obligations of the partnership and the wrongful acts of copartners in the partnership business. A notice given to any partner concerning the business affairs of the partnership is considered notice to the partnership, except in the case of a fraud on the partnership committed by, or with, the consent of that partner (3).

A partnership is liable for loss or injury to any person that is not a partner in the business caused by a wrongful act or omission of any partner acting in the ordinary course of the business or with the consent of the copartners (4). A general partner's liabil-
ity to existing business creditors continues after the partnership has been dissolved. All general partners in a partnership have unlimited liability, which extends to the personal assets of the general partners.

**Business Entity**

A general partnership usually owns property and conducts business in the firm's name. Even though a partnership's name may be used in a lawsuit, the general partners' names are also usually listed because they are completely liable for all debts and obligations of the farm business. Each partner in a general partnership is liable for the acts of a copartner as long as the copartner is conducting the partnership business in its usual manner. However, the liability of a partner in a general partnership does not extend to the personal debts and obligations of the other partners. If a partner's personal assets are not sufficient to meet his debts, a creditor may take legal action to require the partnership to pay the debtor-partner's share of partnership profits to the creditor until the debt is discharged. This procedure permits the general partnership to continue to operate without being restricted by the personal financial problems of a partner.

**Business Continuity**

The death or withdrawal of a general partner, unless otherwise provided for in the partnership agreement, dissolves the partnership. If no definite terms are stated in the partnership agreement regarding the withdrawal of a partner, any partner may withdraw at will, forcing the dissolution of the partnership. If there is an agreement, and a partner withdraws contrary to its terms, the remaining partners have the right to buy out the interest of the withdrawing partner. Continuation of the partnership can only be assured through effective provisions in the partnership agreement.

**Transferability of Interest**

General partners usually have a close personal relationship because of the high degree of trust among partners necessary for operation of the business. Efficiency in management is more likely to occur in a general partnership because participation in the business enterprise is limited. A general partner cannot legally transfer ownership interest with management or administrative
rights without the unanimous consent of all the partners unless the right to do so is stated in the partnership agreement. Thus, a general partner has the distinct advantage of not having an unwanted partner who could interfere with the management or administrative duties of the firm.

A general partner may legally convey an interest in the partnership to a third party without the copartners' unanimous consent and without dissolving the partnership. Such a conveyance, however, does not entitle the third party to participate in the management or administration of the partnership business or affairs, or to require any information or account of partnership transactions, or to inspect the partnership books (5). The third party is entitled to receive the profits derived from the partnership that the assigning partner would have otherwise received. If the partnership is dissolved, the third party is entitled to receive the assignor's interest in the partnership and may legally require an account of the partnership’s business transactions only from the date of the last account agreed to by all the partners.

Management and Control

A general partnership is free of most government regulations and restrictions and can be managed and operated with little formality. Partners make management decisions in accordance with the provisions stated in the partnership agreement. Continuity in management may be difficult if several partners are involved because unanimous agreement for major decisions is usually required from all the partners and personal conflicts may arise. Unless otherwise stated in the partnership agreement, majority rule refers to one vote per partner and not to a majority interest in the partnership.

Generally, each general partner has an equal right to actively participate in the management and control of the partnership. Since each partner in a general partnership has the power to bind the partnership in agreements, a high level of confidence among copartners is essential. A partner may bind the partnership (and thus the personal assets of the copartners) by seemingly conducting the business of the partnership in the usual manner, even though the action taken may be contrary to the express authority of the majority. However, a partner may threaten to dissolve the partnership if any action is taken without unanimous approval. This prevents arbitrary control by the numerical majority.
Credit Acquisition

There is no minimum capital statutory requirement for a general partnership in Alabama. Capital for operation of the farm business and/or investment can be obtained by borrowing, purchasing on credit, or by investing profits derived from the farm business, if the partners agree to do so. The opportunity to pool capital and resources is a major attraction of the general partnership. The capital and credit of a general partnership are limited by the resources of the individual partners. Additional capital may be obtained from new partners brought into the partnership. Each partner is personally liable for all debts and obligations of the partnership.

Limited Partnership

A limited partnership is composed of (1) one or more general partners who assume management responsibility of the business and are personally liable for all obligations of the partnership as are participants in a general partnership, and (2) one or more limited partners who supply capital inputs and share in profits but are not liable for partnership losses or obligations beyond their capital contribution. A limited partner cannot take an active part in management of the business. A limited partner is not personally liable as a general partner for the debts and obligations of the partnership beyond his investment in the business unless the limited partner becomes an effective general partner by participating in the management of the business and holding himself out to the community as a partner.

Formalities of Organization

Two or more persons wishing to form a limited partnership in Alabama must sign a written partnership agreement which states (6):

1. The name of the partnership — The surname of a limited partner cannot be used in the partnership name unless it is also the surname of a general partner or the business had been carried on under a name in which the limited partner’s surname appeared. A limited partner who knowingly allows the use of his surname in the partnership name shall be liable as a general partner to the creditors that extended credit to the partnership without knowledge that the said limited partner was not a general partner. The
name of every limited partnership in Alabama must contain the word "Limited" or its abbreviation, "Ltd."

2. The character of the business — A limited partnership may legally carry on any business that a partnership without limited partners may carry on, except banking or insurance business.

3. The location of the principal place of business of the partnership in Alabama.

4. The name and place of residence or principal place of business of each partner. Each partner must be designated as either a general or a limited partner.

5. The duration for which the partnership is to exist.

6. The amount of cash and the agreed value of the other property contributed by each limited partner and a description of the contributed property.

7. The additional contributions, if any, agreed to be made by each limited partner and the times at which, or upon the happening of events, that such contributions shall be made.

8. The time, if agreed upon, that each limited partner's contribution is to be returned.

9. The share of the profits or other compensation that each limited partner will receive due to each limited partner's contribution.

10. The right, if given, a limited partner has to substitute an assignee as a contributor, and the conditions and terms of the substitution.

11. The right, if given, for the admission of additional limited partners.

12. The right, if given, of one or more of the limited partners to priority over other limited partners pertaining to contributions or compensation by way of income, and the nature of such priorities.

13. The right, if given, of the remaining general partner or partners to carry on the business upon the death, retirement, or insanity of a general partner.

14. The right, if given, of a limited partner to demand and receive property other than cash in return for his contribution.

The limited partnership agreement must be sworn to by one or more general partners. A duly empowered attorney-in-fact or agent may sign the certificate for any one or more limited partners. The signed limited partnership agreement must be recorded in the office of the judge of probate of the county in which the
principal place of business of the partnership, as designated in the partnership agreement, is located (7).

The limited partnership agreement will be cancelled when the partnership is dissolved or all the limited partners cease to be limited partners. The limited partnership agreement will also be cancelled when:

1. There is a change in the name of the partnership or in the character or amount of the contribution of any limited partner.
2. A person is substituted as a limited partner.
3. Another limited partner is admitted into the partnership.
4. A person is admitted as a general partner.
5. A general partner dies, becomes insane, or retires and the business is continued under a right to do so stated in the partnership agreement or with the consent of all members.
6. There is a change in the character of the business of the partnership.
7. There is a false or erroneous statement in the partnership agreement.
8. There is a change in the time as stated in the partnership agreement for the dissolution of the partnership or for the return of a contribution.
9. A time has been agreed upon for the dissolution of the partnership or the return of a contribution, and no time was specified in the recorded partnership agreement.
10. The partners desire to make a change in any other statement in the recorded limited partnership agreement so that it will accurately state the existing agreement between all partners (8).

A person may be both a general partner and a limited partner in the same partnership at the same time. Such a person shall have all the rights and powers of a general partner and be subject to all the restrictions of a general partner, except that in regard to the contribution made, the said partner shall have all the rights against the other member as if said partner were only a limited partner.

**Liability**

A general partner in a limited partnership is subject to all the restrictions and liabilities of a partner in a general partnership agreement. Thus, general partners, either in a general or limited partnership, are personally liable for all the firm's obligations and actions of other general partners in the partnership business.
A limited partnership agreement insulates the limited partners against unlimited liability for the firm's obligations. A limited partner's liability for the firm's obligations is limited to the extent of the investment made in the partnership. A limited partner is not subject to the liabilities of a general partner as long as the limited partner does not participate in the management and control of the business or in the conduct of the firm's business by rendering services. If a limited partner acts as an agent for the partnership in any way, he is liable as a general partner (9).

**Business Entity**

The business entity of a limited partnership is the same as for a general partnership as far as the general partners are concerned. The limited partners, however, enjoy separate business entity to some extent since limited partners are liable for the obligations of the business only to the extent of contributions made to the firm.

**Business Continuity**

Some degree of continuity of existence can be provided for in a limited partnership. Most limited partnership agreements specify that a limited partner's capital contribution cannot be withdrawn until an agreed upon date. However, if no time is specified in the limited partnership agreement for the withdrawal of the limited partner's contribution or for the dissolution of the partnership, the limited partner can legally withdraw his capital contribution after giving 6 months' notice in writing to all other members of the partnership. A limited partner only has the right to demand and receive cash in return for his contribution unless there is a statement in the limited partnership agreement to the contrary or all of the partners consent to return the actual contribution to the limited partner. A limited partner may have the partnership legally dissolved if the rightful and legal request for the return of the contribution or contributions made to the partnership is unsuccessful (10).

The death of a limited partner does not cause a dissolution of the partnership. A limited partner's interest in a partnership is considered to be personal property. Thus, a limited partner's interest is assignable to another person or estate. If the limited partnership agreement specifically gives the limited partner the right to substitute an assignee in his place, then the substituted partner is legally entitled to all the rights of the limited partner
who died or assigned his interest in the partnership. If the agree-
ment does not give the limited partner the right to substitute an
assignee in his place, then the assignee is only entitled to receive
the share of the profits or other compensation by way of income,
or the return of his contribution, to which the assignor would
have otherwise been entitled.

An assignee has no right to require any information or account
of the partnership transaction, or to inspect the partnership books
until he becomes a substitute limited partner. An assignee may
become a substitute limited partner with the consent of all the
partners except the assignor. As previously mentioned, if the lim-
ited partnership agreement gives the limited partner the right to
substitute an assignee in his place, then the assignee is automatical-
ly considered a limited partner once the assignee’s name has been
amended to the limited partnership agreement and recorded (11).

A limited partnership is terminated by the retirement, death,
insanity, or mental incapacity of all the general partners. Retire-
ment, death, insanity, or mental incapacity of fewer than all the
general partners in a limited partnership does not necessarily
mean dissolution of the partnership. The partnership business
may be continued by the remaining general partner or partners
if the right to do so was stated in the recorded limited partnership
agreement, or with the consent of all remaining partners (12).

Although more continuity of existence can be assured in a lim-
ited partnership than in a general partnership (if more than one
general partner exists in the limited partnership), the limited
partnership still lacks the perpetual existence of a corporation.

Transferability of Interest

The consent of all general partners in a general or limited
partnership is required before any transfer of a general partner-
ship interest with management rights and responsibilities can take
place. Thus, a general partner has the distinct advantage of not
having an unwanted partner who will participate in the manage-
ment of the firm thrust upon him. However, the general partner
has a clear disadvantage in that the only means of disposing of
his interest in the firm may mean liquidation of his interest.

As mentioned earlier, a limited partner may assign his interest.
However, the assignee may become a substitute limited partner
with all the rights of a limited partner only if all the partners give
their consent, or if the assignor was given the right in the limited
partnership agreement to make an assignee a substitute limited partner.

Since limited partners cannot actively participate in the management and control of the business, the limited partnership form of business organization combines the advantages of (1) restricting management to a small number of general partners without fear of interruption from undesirable outsiders with (2) giving the investors or limited partners the unrestricted right to dispose of their contributions to the partnership by sale rather than through liquidation (33).

Management and Control

As in a general partnership, management and control in a limited partnership are vested in the general partners. If the limited partners participate in the control or act as agents of the business, they lose their limited liability status and become personally liable for all obligations of the partnership firm. Thus, the limited partnership is a form of business organization in which a partner is willing to assume the risk as a general partner by managing the business, while the other members are willing to invest in the firm as limited partners. The limited partners share in the profits of the business, but are not personally liable for the obligations of the firm, except to the extent of the contributions made to the business, and do not participate in management or perform services for the business firm.

Credit Acquisition

The limited partnership obtains its capital from the general partners and from outside investors who become limited partners. Outside investors are interested in becoming limited partners because they do not wish to participate in management responsibilities and are attracted by the possibility of sizeable returns on their investment through participation in the profits of the business.

One disadvantage of the limited partnership as a means of attracting capital is the difficulty of disposing of a limited partner's interest in the business firm. Even though a limited partner can readily transfer his interest in the business to an assignee, there are practical limitations to finding a purchaser for such a business interest. The transfer of an investment of a limited partner is not nearly as flexible as the transfer of shares of corporate stock.
Regular Corporation

A corporation is a body of natural persons formed and authorized according to state law, to act as a separate legal entity (having a personality and existence distinct from that of its human agents), with its own rights and responsibilities. The fact that a corporation is a separate, distinct, legal entity is important. A corporation is viewed as a legal “person” although it must act through its human agents who act as owners, managers, and/or employees. A corporation has most of the rights and privileges that natural persons have. A corporation can own real and personal property, can enter into contractual agreements, can sue and be sued, and is a separate taxpayer from its owners.

Formalities of Organization

Since the corporation is a creature of state law, a farming operation cannot do business as a corporation in Alabama until the State of Alabama recognizes it as such. A farm corporation is usually organized in the state in which its property is located. Unless the corporation plans to carry on extensive business operations outside the state, there is not usually a distinct advantage to incorporate in another state. Foreign incorporation often has disadvantages. Reports to all states in which the corporation does business are usually required and the tax laws of all states involved generally apply. If the corporation will hold property or have business operations in more than one state, the incorporation laws of the states involved usually determine the state in which incorporation will take place. However, most businesses incorporate in the state where the major business operation is located. If a corporation plans to do business in states other than the state of incorporation, it will have to meet the requirements specified by those states.

The usual steps in forming a corporation in Alabama are:

1. The incorporators file an application to reserve a corporate name.
2. The incorporators adopt a preincorporation agreement.
3. The incorporators draft, sign, verify, and file the Articles of Incorporation with the probate judge of the county in which the corporation will have its initial registered office.
4. The corporation issues shares of stock in exchange for money or other assets.
5. The shareholders meet to adopt the bylaws of the corporation.

6. The directors meet to elect officers and begin business in the name of the corporation.

An applicant can reserve the exclusive right to the use of a corporate name with the secretary of state. The name may also be reserved by telephone or other electronic means, subject to requirements that may be set by the secretary of state. If the name requested is available for corporate use, the secretary of state will reserve the name for the exclusive use of the applicant for a period of 120 days. The secretary of state will issue the applicant a certificate showing that the name has been reserved.

The reserved right to the exclusive use of a specified corporate name may be transferred to any other person, partnership, domestic corporation, or foreign corporation by filing a notice of such transfer with the secretary of state. The notice of transfer must be executed by the applicant for whom the name was reserved, and must specify the name and address of the transferee. The right to reserve the exclusive use of a specified corporate name is entirely new to Alabama law (13).

Any corporation organized and existing under the laws of any state or territory of the United States may register its corporate name in Alabama, provided its corporate name is not the same as, or deceptively similar to, the name of any domestic corporation formed according to the laws of Alabama, or the name of any foreign corporation authorized to transact business in Alabama, or any corporate name reserved or registered with the secretary of state.

Such registration can be made by filing with the secretary of state:

1. An application for registration executed by an officer of the corporation, stating the name of the corporation, the state or territory under the laws of which it is incorporated, the date of incorporation, a statement that it is currently carrying on business, and a brief statement of the type of business it is engaged in.

2. A certificate stating that the corporation is in good standing under the laws of the state or territory wherein it is organized, executed by the secretary of state of such state or territory or by another official who has custody of the corporate records.

A registration fee in the amount of $1.00 for each month, or fraction thereof, between the date the application is filed and
December 31 of the calendar year in which the application is filed, but in no instance less than $5.00, is payable to the secretary of state. This registration will be effective until the close of the calendar year in which the application was filed.

A corporation that has its corporate name registered in Alabama may renew such registration from year to year by filing an application for renewal with the secretary of state between the first day of October and the last day of December. This will extend the registration for the following calendar year.

The registration of a corporate name and the renewal of a registered corporate name are entirely new to Alabama law. The Alabama Code as revised in 1980 substantially expands the protection given the name of a corporation (14). The purpose of the current statute is to protect the public against confusion between corporations and to protect the corporation against unfair competition. For corporations organized prior to January 1, 1981, it would suffice to use the words “company” or “limited,” or an abbreviation thereof, in the corporate name. As previously mentioned, the Alabama Code now requires the word “corporation” or “incorporated,” or an abbreviation thereof, in the corporate name. This change was deemed desirable to avoid confusion with the growing number of limited partnerships where words or abbreviations such as “Co.” or “Ltd.” are commonly used in the partnership name.

Preincorporation Agreement. Although it is not legally required, the incorporators can make a preincorporation agreement which states the major rights and duties of the parties involved after the existence of the corporation is recognized by the state.

A preincorporation agreement for a farm corporation usually includes: the agreement to incorporate the business; the kind and number of shares that each shareholder agrees to acquire; stock transfer restrictions (if any); the prospective officers and directors, their duties, and their salaries; voting rules and procedures; and other important items, such as decisions that will require unanimous approval. Most of the items included in the preincorporation agreement will also be included in the articles of incorporation and/or the bylaws of the corporation.

Articles of Incorporation. One or more persons, partnerships, domestic corporations, or foreign corporations may act as
incorporator(s) of a corporation in Alabama by signing the articles of incorporation and delivering them to the probate judge of the county in which the corporation will have its initial registered office (28).

The Alabama Code required three or more natural persons as incorporators until January 1, 1981. Since the life of most corporations is perpetual, the role of incorporator is neither significant nor lasting in effect. In recognition of this, the Alabama Code, as of January 1981, permits incorporation by one or more persons, without specification of age, and also permits a partnership, domestic corporation, or foreign corporation to act as the sole incorporator.

The articles of incorporation set forth the powers and limitations of the corporation and its shareholders. It is the basic charter or governing instrument of the corporation and must contain the following:

1. The name of the corporation — The name of any corporation organized in Alabama after January 1, 1981, must contain the word “corporation” or “incorporated” or an abbreviation of one of these words.

2. The period of duration — The period of duration may be limited to a specified period, or be perpetual.

3. The purpose or purposes for which the corporation is organized — The purpose or purposes for which the corporation was organized may be specifically stated, or may include the purpose of transacting any or all lawful businesses for which corporations may be incorporated according to Alabama law.

4. The aggregate number of shares that the corporation will have authority to issue — If all shares of stock consist of one class only, the par value of each share must be stated, or it must be stated that all shares have a nonpar value. If the shares of stock are divided into classes, the number of shares of each class and the par value of the shares of each class, or that the shares have a nonpar value, must be stated.

5. Designation of each class of stock — If the stock is divided into different classes, each class must be designated, stating the preferences, limitations, and relative rights in respect to the shares of each class.

6. Designation of each series of stock — If the corporation will issue any preferred or special class of stock in series, each series
must be designated and a statement of the variations in the relative rights and preferences between series made.

7. Stock transfer restrictions — If the incorporators decide to adopt any provision restricting the transfer of stock, this must be included in the articles of incorporation.

8. Location of the corporation — The location and mailing address of its initial registered office, and the name of its initial registered agent at this address, must be given.

9. The members of the board of directors — The number of directors constituting the initial board of directors and the names and addresses of the persons who will serve as directors until the first annual meeting of the shareholders or until the successors can be elected and qualify as such must be given.

10. List of incorporators — The name and address of each incorporator must be given.

The current Alabama law relative to formation of corporations was taken from the Model Corporation Act and differs from former Alabama law. The new law eliminates the requirement that the articles of incorporation be signed by all the initial subscribers to the capital stock. The new law also simplifies the task of the draftsman of the articles of incorporation by making it clear that the powers enumerated by Alabama law need not be set forth in the articles of incorporation. The minimum capital requirement under the former Alabama Code section 10-2-23 of $1,000 is eliminated (29).

ISSUANCE OF STOCK. A corporation has the power to create and issue the number of shares stated in its articles of incorporation. The shares may be divided into one or more classes, any or all of which may consist of shares with or without a par value. The articles of incorporation may either limit voting rights or provide special voting rights for the shares of any class of stock (15). Shares may be either common or preferred.

It is often sufficient for a small farm corporation to issue only common stock, although other classes of stock may be authorized. The choice to be taxed as a tax-option corporation may be made if only one class of stock has been issued. However, preferred shares may be especially useful if the corporation becomes regularly taxed and has some shareholders who contribute capital but take no active part in the management and operation of the business. Preferred stock dividends may be paid without paying divi-
dends on common stock. The consideration for the issuance of shares may be paid, in whole or in part, in money, in labor or services actually performed for the corporation, or in other property actually received. Neither promissory notes nor future services may constitute payment or partial payment for the issuance of shares of a corporation (16).

**Bylaws and Officers.** The bylaws of a corporation are the rules which govern the manner in which the day-to-day business of the corporation is conducted. Items which may be included in the bylaws are the time and place for shareholders’ and directors’ meetings, a quorum requirement, a list of officers and their duties, the fiscal year, the bank to be used, types of insurance protection to be provided, and limitations on the authority of officers to borrow money and to enter into contractual agreements in the corporation's name.

The officers of a corporation are elected by the board of directors to perform the regular business duties of the corporation. Corporations created in Alabama must have a president and a secretary, although both offices may be held by the same individual. The bylaws and officers of a corporation regarding management and control of a corporation are discussed in more detail later.

**Liability**

The limited liability aspect of the corporate form of business organization is the primary reason that many farm businesses choose to incorporate. Once a corporation is properly organized in accordance with the statutes of the state of incorporation, the shareholders are liable for the action and obligations of the corporation only to the extent of their investment in the corporation.

Limited liability of the shareholders of a corporation is only beneficial to the shareholders who have assets that are not included in the corporation. If a farmer transfers all of his assets to the corporation, limited liability is almost meaningless. Many businesses and lending institutions require one or more shareholders to sign a personal guarantee for open business accounts and loans made to the corporation. If a shareholder personally guarantees an open account or loan, that shareholder’s personal assets are legally obligated and may be required to satisfy the personal guarantee if the corporation does not have sufficient assets to do so.
Since the corporation is a separate, legal entity, it can enter into contractual agreements, can sue, and can be sued. The corporation is liable for damages caused by the negligent actions of its officers and employees, provided the officers and employees were acting within the scope of their employment at the time the damages occurred. An employee, officer, or director of a corporation may be held personally liable for negligent actions even though the corporation is also liable. In other words, shareholders may be held liable, not as shareholder-owners but in their capacities as employees, officers, or directors (32).

The assets of a corporation may not directly be used to satisfy a shareholder's personal debts or obligations. However, a creditor of an individual shareholder may require the shareholder's personal property, which includes shares of stock in a corporation, to satisfy the shareholder's personal debts. Thus, it is possible that a creditor of a shareholder might obtain an interest in, or control of, a corporation by levying on stock to satisfy a debt or an obligation of a shareholder. If there are stock transfer restrictions that do not allow outsiders to own stock in the corporation, the remaining shareholders may be forced to buy the stock. In any event, the creditor of a shareholder cannot reach the assets of the corporation.

**Business Entity**

A corporation is an artificial creature organized according to state law. It is a separate business entity completely distinct from its owners or shareholders. This sharp line of distinction between the business and the owners is one of the major characteristics of the corporate form of business organization. The corporation is a legal person separate from its shareholder-owners.

A corporation is the only form of business organization that completely possesses the right to sue or to be sued, hold or deal in real property, and enter into contractual agreements in the firm's name. All jurisdictions recognize a corporation as a separate, legal entity. The federal courts recognize the corporation as a legal citizen of the state in which it was incorporated and also the state in which its principal place of business is located.

**Business Continuity**

The life of a corporation does not depend upon the lives of people unless the articles of incorporation tie the life span of the
corporation to the shareholders. Most states permit perpetual corporations. The perpetual existence of a corporation is not interrupted by the death of a shareholder or by the transfer of stock in the corporation. The business continues to exist and operate as a separate legal entity, legally unaffected by the life span or whims of an individual shareholder. However, it should be realized that without adequate planning, the death or withdrawal of a major shareholder and the entry of a new shareholder may have serious consequences. But the perpetual nature of the corporation offers a method of maintaining the farm business as a productive economic unit and avoiding the problems of business interruption that result upon the death of a sole proprietor or general partner.

Continuity of existence may pose a danger to the minority shareholder. Shares of stock in a closely held corporation usually do not have a ready market. Therefore, the estate of a deceased stockholder may not have any readily available means of recovering the capital investment. To avoid this situation, the articles of incorporation, bylaws, or separate shareholder agreement may include provisions requiring or permitting the purchase of shares of stock by the corporation or the remaining shareholders, if a shareholder dies or wishes to liquidate his or her stock. A stock purchase plan funded by life insurance proceeds offers another alternative.

Even a perpetual life corporation may be terminated or dissolved. A corporation may be voluntarily dissolved by the written consent of all the shareholders or by the board of directors adopting a resolution recommending that the corporation be dissolved and the resolution being adopted by at least two-thirds of the shares of the corporation entitled to vote. If any class of shares is entitled to vote as a class, the resolution to dissolve the corporation can only be adopted upon receiving the affirmative vote of the holders of at least two-thirds of the shares of each class of shares entitled to vote as a class and at least two-thirds of the total shares entitled to vote (30).

A corporation may be involuntarily dissolved by an order of the circuit court of the county in which the registered office of the corporation is located. The attorney general will file the necessary action for involuntary dissolution once it is established that:

1. The corporation has failed to file an annual report within the time specified by law, or has failed to pay the franchise tax on
or before 6 months after the date the franchise tax was due and payable; or
2. The corporation obtained its articles of incorporation through fraudulent means; or
3. The corporation has repeatedly and willfully exceeded or abused the authority vested in it by law; or
4. The corporation has failed to appoint and maintain a registered agent in Alabama for 30 days or more.

Certain grounds for involuntary dissolution are also available to shareholders and creditors (31).

Transferability of Interest

Another favorable characteristic of a corporation is the flexibility it offers to transfer ownership interest in the business. Shares of stock provide a simple and convenient means of transferring ownership during life and at death without disrupting the continuity of the business. If executed properly, the corporate form of business organization can be used to minimize estate taxes, thus conserving more of the estate for the heirs. It is much easier to transfer shares of stock by gift or sale than bulky assets such as land, livestock, and equipment. Upon the transfer of title to land, livestock, or equipment, the farmer legally loses all control over the transferred property. However, the transfer of shares of stock in a corporation can provide an orderly and gradual shift in ownership and management of the farm business. Retention of 51 percent of the stock preserves control, even though the other 49 percent may have been given away or sold. The current annual federal gift tax exclusion is $10,000 per recipient per year per donor, or $20,000 per recipient per year for husband and wife donors.

Refined arrangements are possible for division of ownership and management control. A regular corporation may have more than one class of stock. If the corporate structure includes non-voting or preferred stock, an interest in the income or assets may be transferred while management control is retained. Thus, ownership of an interest in a corporation is divisible in many ways not available to a partnership or a sole proprietorship. This does not apply to Subchapter S corporations since they may have only one class of stock (35).

Many farm corporations are organized as closed corporations that have stock transfer restrictions. Such an agreement provides
assurance that outsiders will not be able to obtain stock in the farm corporation. A stock transfer restriction agreement is crucial when a stockholder dies or decides to sell. Under a stock transfer restriction agreement, other shareholders in the corporation or the corporation itself are either obligated or given the legal right to purchase the withdrawing stockholder’s shares. This may be a right of first refusal or an absolute right to buy at a price that is generally based on the value of the stock at the time of the transaction. A formula or standard of valuation to determine the value of the stock is often contained in the stock transfer restriction agreement.

Management and Control

The powers of corporate management are vested in three decision-making groups — the shareholders, the board of directors, and the officers. In a small farm corporation, the same individuals may serve in all three capacities, thereby simplifying the decision-making process. Due to this commonality in membership, the shift of entrepreneurship may be negligible. It is important to understand the separate functions of each group so that each official will act within his proper capacity.

SHAREHOLDERS. Shareholders are legally required to hold annual meetings to transact business, such as electing directors, acting on financial reports, and providing guidance to the corporation. Special meetings of the shareholders may be called by the board of directors, the shareholders of at least one-tenth of all the shares entitled to vote at the meeting, or other persons authorized in the articles of incorporation or the bylaws (17). Shareholders are entitled to one vote per outstanding share, regardless of class, on each matter submitted to a vote at a meeting of the shareholders, unless otherwise provided in the articles of incorporation.

The shareholders direct the affairs of the corporation through directors elected by them. In the election of directors, each shareholder is entitled to votes equal to the number of shares owned by him multiplied by the number of directors to be elected. If cumulative voting is allowed by the articles of incorporation, a shareholder may cast all the votes he is entitled to for one candidate or distribute them among any number of candidates as he wishes (18). Shareholders also have the power to remove directors, with or without cause, at a meeting of the shareholders expressly
called for that purpose. If a director is removed, the shareholders should elect a successor for the unexpired term at the same meeting. This statutory provision eliminates the requirement of cause for removal of directors. This change is based on the theory that the shareholders should have ultimate control over the management of the corporation. The ability to remove directors, without the requirement of cause for removal, gives the shareholders this degree of management control. The right of removal of a director no longer hinges on the nature of the director’s conduct but on the single question of whether the shareholders desire to retain him as a director (23).

Any action that can be taken at a meeting of the shareholders may be taken without a meeting if all the shareholders entitled to vote on the given subject matter give their written consent. Such consent will have the same effect as a unanimous vote of the shareholders (19). Action by written consent is common in a farm corporation where the shareholders work closely together, or if one or more of the shareholders lives a long distance from the farming operation.

Shareholders must meet in accordance with the bylaws of the corporation. The initial bylaws of the corporation are adopted by the shareholders. The power to alter, amend, or repeal the bylaws or adopt new bylaws is vested in the board of directors unless granted to the shareholders by the articles of incorporation. However, the board of directors may not alter, amend, or repeal any bylaw that establishes a quorum at shareholders’ meetings. The bylaws may contain any provision for the regulation and management of the affairs of the corporation that are not inconsistent with law or the articles of incorporation (18).

Directors. The directors of a corporation are usually given broad authority in the bylaws to oversee the affairs of the corporation. Directors must be natural persons, but they do not have to be residents of Alabama or shareholders of the corporation unless it is required by the articles of incorporation or the bylaws (20). The board of directors of a corporation must consist of one or more members. Alabama law thus recognizes the practice of one-person management, which is common in small corporations. The initial number of directors to be elected at the first meeting of the shareholders is specified in the articles of incorporation. Directors are elected at each annual shareholders meeting and
hold office until the next succeeding annual meeting. The number of directors may be increased or decreased by amending the articles of incorporation or the bylaws (21).

If a vacancy occurs on the board of directors due to death, resignation, or other cause, the vacancy may be filled by an affirmative vote of a majority of the remaining directors, unless such action is prohibited by the articles of incorporation or bylaws. A director elected to fill a vacancy will serve until the next annual meeting of the shareholders. A directorship to be filled due to an increase in the number of directors must be filled by an election at an annual shareholders’ meeting or at a special meeting of shareholders specifically called for that purpose (22).

A meeting of the board of directors does not have to be formal or regularly called. Regular meetings of the board of directors may be held with or without notice as prescribed in the bylaws. Special meetings of the board of directors may be held after such notice as is prescribed in the bylaws. If all directors are present, they may act as a board and legally bind the corporation. If all the directors are not present, the quorum rules in the articles of incorporation or the bylaws will apply. If neither the articles of incorporation nor the bylaws of the corporation contain any quorum rule, a majority of the directors will constitute a quorum for the transaction of business (24). Any action that may be taken at a meeting of the board of directors may be taken without a meeting if a consent in writing, stating the action taken, is signed by all the directors. Written consent will have the same effect as a unanimous vote of the directors (25).

Officers. The officers of a corporation act as its agents who are authorized and directed to perform the regular business duties of the corporation, to receive and pay out money in the operation of the business, and to maintain adequate records of all business transactions. The officers are elected by the board of directors according to the time and manner specified in the bylaws. The officers of a corporation created according to Alabama law must consist of a president and a secretary. Other officers, assistant officers, and board of directors are chosen in a manner prescribed in the bylaws. A person may hold any number of offices unless the bylaws specify otherwise. This provision also recognizes the so-called “one-man” corporations where, substantially, all the shares of stock are owned by one person and that person is also the general manager of the corporation’s day-to-day business (26).
As mentioned earlier, an Alabama corporation is also allowed to function with only one director. An officer may be removed by the board of directors if the board feels that such action will serve the best interests of the corporation (27).

Credit Acquisition

The corporation is the traditional form of business organization used for attracting capital from outside investors. A corporation is initially financed by the issuance of stock in exchange for cash and/or property. The possibility of raising capital through the sale of shares of stock in a small farm corporation is usually more illusory than real. Generally only large business corporations enjoy an actual market for their stock. Most farm corporations are closed corporations and thus have stock transfer restrictions which prohibit the sale of stock to outsiders, thus eliminating the attraction of capital from outside investors.

Credit acquisition is largely determined by security and management rather than the form of business organization. Production Credit Associations and Federal Land Banks, as well as many commercial banks, permit loans to farm corporations but usually require majority shareholders to act as personal guarantors of the indebtedness. When such personal guarantees are required, the most attractive feature of incorporation (limited liability) is lost. A farm corporation with sufficient assets may have easier access to credit because the corporate form of business organization insures that the farm will continue to operate as a single economic unit virtually unaffected by the death of a shareholder, provided the corporation has sufficient depth in management capability.

Subchapter S Corporation

If a corporation meets certain requirements, the shareholders may elect to become a Subchapter S (tax option) corporation. Small business and family corporations may qualify for the election of the tax-option status by meeting the following requirements:

1. It must be a domestic corporation.
2. It must not be a member of an affiliated group.
3. It must have only one class of stock.
4. It must not have more than 25 shareholders.
(5) It must have only individuals, estates, grantor trusts, voting trusts, and certain testamentary trusts as shareholders.

(6) It must not have a nonresident alien as a shareholder.

(7) It must not derive more than 80 percent of the corporation’s gross receipts for a tax year from sources outside the United States.

(8) It must not derive more than 20 percent of the corporation’s gross receipts for a tax year from passive investment income.

The election may be made at any time during the prior tax year or within the first 75 days of the tax year to which it applies. A husband and wife and their estates are treated as one shareholder in determining the number of shareholders in the corporation. All persons who are shareholders of the corporation on the day of election to become a Subchapter S corporation must consent to the election in a signed statement. If a person who was not a shareholder on the day the election was made becomes a shareholder and affirmatively refuses to consent to the election within 60 days after the stock was acquired, the election is terminated (34).

Subchapter S election does not cause a corporation to lose its other corporate attributes. Except for amending the articles of incorporation to state that the corporation will operate as a Subchapter S corporation, the formalities of organization are the same as for a regular corporation. The only attribute that changes to any large degree is federal income taxation. While the election is in effect, the corporation is not subject to the corporate income tax, the accumulated earnings tax, or the personal holding company tax. For income tax purposes, the Subchapter S corporation passes through to shareholders for inclusion in the shareholders’ individual income tax returns for the year of distribution, their pro rata shares of corporate taxable income, capital gains, operating losses, and qualified investment for investment tax credit purposes.

The State of Alabama does not recognize a Subchapter S corporation and, therefore, corporations selecting the Subchapter S option are treated as a regular corporation in terms of Alabama state income taxes.

**Multiple Entities**

A combination of organizational business structures may facilitate the objectives of the parties involved in a farming operation.
better than a single organizational structure. The single entities which may be used to form a multiple entity are the sole proprietorship, general partnership, limited partnership, regular corporation, Subchapter S corporation, and business trust. Since each of these forms of business organization is created by state or federal law, the applicable organizational rules and requirements for each separate entity must be strictly adhered to in the formation of multiple entities.

In most multiple-entity farm business organizations, one entity retains land ownership while a second entity, often called the production entity, retains title to the machinery, livestock, equipment, and inventory. If the parents retain control of the entity that owns the land, rental income derived from land leased to the production entity can help meet the parents' retirement goals without affecting Social Security benefits. By keeping the land as a separate business entity, a more equal allocation of wealth among the heirs may be achieved without the off-farm heirs acquiring an interest in the production entity. Thus, the multiple-entity format may be used to reduce the required investment of on-farm heirs in gaining control of the production side of the multiple entity. On-farm heirs generally want to have control of the production entity no later than the time of death of the surviving parent to avoid a forced liquidation by off-farm heirs.

Disadvantageous tax consequences may result from the creation of a multiple entity. Substantial time and effort are often required to change the organizational structure of a business. The expense typically involved, as well as the potential income tax liability arising from dissolution and liquidation of one entity and the formation of another, strongly suggests that any change in organizational business structure be carefully planned with the aid of an attorney and/or an accountant.

**SUMMARY AND CONCLUSIONS**

Farm businesses are growing larger, including more multiple-person operations, and becoming more highly capitalized. It is more difficult to begin and transfer larger, highly capitalized farming operations. Thus, more attention is being given to credit acquisition, ownership liability, and intergenerational transfer of both management and ownership. The proper form of business organization can aid in credit acquisition and limit ownership liability.
The purpose of this study was to examine the various forms of business organization available to Alabama farmers. The specific objective was to examine Alabama and federal legislation relative to formation, operation, and dissolution of the various forms of business organization.

The three basic forms of business organization are the sole proprietorship, the partnership, and the corporation. A partnership may consist of both general and/or limited partnership agreements. The corporate form of business organization may be subdivided into the regular corporation and the Subchapter S (tax option) corporation.

The sole proprietorship is a form of business organization in which one individual (the owner) owns or controls all equity interest in the business, receives all business income, absorbs all business losses, and assumes full liability for all obligations of the business.

A general partnership is an association of two or more persons to carry on as coowners of a business for a profit. Each partner contributes his assets to the business and actively participates in management and business activities of the partnership. A high level of confidence among the copartners is essential because each partner may legally bind the partnership (and thus the personal assets of the copartners) by conducting the business of the partnership within the scope of the partnership activities.

A limited partnership is a special form of partnership permitted by state law. A limited partnership must have at least one general partner who assumes management responsibility of the business and who is personally liable for all debts and obligations of the partnership and one limited partner who supplies capital inputs and shares in profits but is not liable for partnership losses or obligations beyond the amount of capital contributed to the business. A limited partner who actively participates in the management of the partnership becomes liable for all partnership obligations as a general partner.

A regular corporation is a legal "person" created according to state law. It is a separate business entity having a personality and existence distinct from that of its owners, who are called shareholders because they own shares of stock or interests in the corporation. The major characteristic of the corporate form of business organization is the sharp line of distinction between the business
and the owners. The regular corporation is a separate taxpayer as well as a separate legal "person."

A Subchapter S (tax option) corporation is created according to federal tax laws. A Subchapter S corporation has the same corporate attributes of a regular corporation except that the Subchapter S corporate entity pays no federal income tax. Instead, each shareholder reports a share of the corporate income, expenses, and credits on his individual federal income tax return.

Before a form of business organization is chosen, the objectives of both the business entity and the owner(s) should be clearly outlined. Some of the objectives to be considered are estate planning, business management, liability, duration of the business, and income tax planning. The objectives of a business are closely intertwined; therefore, all objectives must be considered when choosing the basic form of business organization.

Although the choice of business organizational structure is limited from a legal standpoint, the existing forms of business organization can be considerably modified to meet individual needs. The services of an attorney and/or a certified public accountant can be invaluable in modifying a form of business organization to best achieve the objectives of the business entity and the owner(s).

A form of business organization only provides the means of achieving the objectives of the business entity and the owner(s). Management must utilize the attributes of the form of business organization to best achieve the objectives specified.

The costs associated with the formation of a corporation are usually higher than for the other forms of business organization. However, a farmer who has a profitable farming operation and files as a sole proprietor, partner, or shareholder of a Subchapter S corporation is likely to pay thousands of dollars more in federal income taxes over a period of several years than a farm owner who incorporates his farm business, due to the lower corporate tax rates. A corporation also has the distinct advantages of easier intergenerational property transfer and limited liability.
REFERENCES


