

# The Use of Public Limited Partnership Financing in Agriculture for Income Tax Shelter

## PREFACE

Tax shelters, a topic popular with both the very wealthy and tax reform advocates, became a relevant concern for agriculture in the late 1960's and early 1970's. The public offering of limited partnership investment interests in cattle feeding, cattle breeding, citrus, vineyards, pistachio nuts, and eggs has channeled millions of dollars largely from non-farm sources into agriculture. This monograph takes a look at this investment vehicle and offers a background for assessing the desirability of allowing tax laws to encourage capital inflow into agriculture primarily for tax benefits.

This material represents an effort to inform those concerned about tax policy and the control of agriculture about the fundamentals of the public limited partnership. While the material can readily become outdated with respect to changing tax laws and securities regulation, this report can serve as a foundation towards understanding the interrelationships of law and economics in an agricultural setting.

This report is not intended to replace the advice of an attorney in putting together a limited partnership. Such action should be taken only after consultation with an attorney

## FOREWORD

This is the first in a series of publications from the North Central Regional Project, NC-117, "Organization and Control of the U.S. Food Production and Distribution System." The individuals and organizations that are participating in this project are listed below.

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## INTRODUCTION

Most economists are aware that agriculture has recently attracted considerable investment from high-income individuals seeking tax shelters. The limited partnership, commonly called a "fund," has served as the conduit for much of the capital flow into agriculture during the past five years. An understanding of these funds is important because they represent a new and growing source of competition in agriculture. This study represents both a legal and an economic description of this business form as applied to agriculture.

The scope of this study is confined to the public limited partnership. A public fund is one which has obtained registration clearance from both federal and state securities agencies. Private funds, on the other hand, are those limited partnerships which are not required to be registered with the various securities agencies. They are offered and sold to the financially sophisticated able to fend for themselves in matters of investment in business ventures or to residents of one state, under the intrastate exemption. Such private offerings are a major form of investment conduit. However, this study focuses on the public funds only, because the private funds have less publicly available information for investigation and analysis.

A limited partnership is a partnership having as members one or more general partners and one or more limited partners. Once seemingly restricted to Broadway productions and oil and gas exploration, limited partnerships spread into agriculture within a relatively recent period. While the pioneers in public fund offerings in cattle feeding date back no farther than the late 1960's, the funds by 1973 had become so widespread in cattle feeding that estimates place as much as \$350-\$400 million of tax-induced equity capital in this industry, channeled primarily through the cattle feeding funds.<sup>1</sup> The egg industry has now two large funds, the earlier formed only in late 1972. Limited partnerships are also present in the commodity areas of grape/wine production, citrus, and pistachio nuts. (See Appendix B for a list of agricultural limited partnerships.)

The growth of funds, in agriculture and elsewhere, reflects the taxpayers' search for "tax shelter." The shelter can be a conversion of ordinary income into capital gains income, a deferral of the tax on ordinary income, or both. The quest for some degree of shelter from the federal income tax bite has intensified as rising personal incomes have placed increasing numbers of taxpayers into the upper tax brackets of the progressive income tax system. The desire for shelter exists whether the investor's high income level is temporary or persistent, as income averaging does not apparently achieve the desired reduction in the tax load. Though the limited partnership is not the exclusive route to tax shelter, it is widely employed in the major tax shelter industries of real estate, oil and gas exploration, and cattle feeding.<sup>2</sup>

## THE LIMITED PARTNERSHIP: ITS STATUTORY BASIS

As business organizational form, the limited partnership is wholly a creature of statutory provision, unlike the general partnership with its common law foundation. In the United States, New York was the first to create statutory authority for the limited partnership in 1822. Because the limited partnership was recognized only in civil law countries such as France and Italy, those countries deriving their legal heritage from English common law had to resort to statutory enactment to provide for the limited partnership. In fact, the 1822 New York statute is the first example of adoption from a legal system other than that of England. It was 1907 before England adopted a limited partnership act.<sup>3</sup>

The civil law countries themselves derived the limited partnerships concept from its early usage by merchants during the Middle Ages. Surrogate Alexander W. Bradford, in his opinion in *Ames vs. Downing* in 1850, had the following to say of the 1822 New York statute:<sup>4</sup>

The system of limited partnerships, which was introduced by statute into this state, and subsequently very generally adopted in many other states of the Union, was borrowed from the French Code. 3 Kent, 36; *Code de Commerce*. It has existed in France from the time of the Middle Ages; mention being made of it in the most ancient commercial records and in the early mercantile regulations of Marseilles and Montpellier. In the vulgar Latinity of the middle ages it was styled *commenda*, and in Italy *acommanda*. In the statute of Pisa and Florence, it is recognized as far back as the year 1160; also in the ordinance of Louis-le-Huton, of 1315; the statutes of Marseilles, 1253; of Geneva of 1588. In the middle ages it was one of the most frequent combinations of trade and was the basis of the active and widely extended commerce of the opulent maritime cities of Italy. It contributed largely to the support of the great and prosperous trade carried along the shores of the Mediterranean; was known in Languedoc, Provence, and Lombardy, entered into most of the industrial occupations and pursuits of the age and even traveled under the protection of the arms of the Crusaders to the City of Jerusalem. At a period when capital was in the hands of nobles and clergy, who from pride or caste, or canonical regulations, could not engage directly in commercial enterprises and reaping the profits of such lucrative pursuits without personal risks, and thus the vast wealth, which otherwise would have lain dormant in the coffers of the rich, became the foundation by means of this ingenious idea of that great commerce which made princes of the merchants, elevated the trading classes and brought the commons into position as an influential estate of the common wealth.

Whether the limited partnership made “princes of the merchants” might be subject to question. However, the flowing language of Surrogate Bradford illustrates the early usage of a business form at least resembling that created by New York in its 1822 statute. The concept of the *societe en commandite* espoused in the French Commercial Code and adopted by New York quickly spread to the other commercial states. By the time the Uniform Limited Partnership Act was proposed in 1916, all states except New Mexico had a limited partnership statute, most following the language of the New York statute with little material variation.<sup>5</sup>

The Uniform Limited Partnership Act (ULPA) has been adopted in 48 states with only a few minor alterations. Delaware continues with its own statutory provision, while Louisiana has a provision for the limited partnership based upon its civil law foundation from the French Code. The ULPA consists of thirty-one sections, reference being available to the complete text in Appendix A.

The main formality in creating a fund under the ULPA is the filing of the certificate of limited partnership with the proper public official and payment of filing fees, if any. The proper depository for the certificate may be the recorder of deeds, the secretary of state, or the clerk of the county court. Missouri and New York further require the publication of the certificate or its substance.

The certificate itself is divided into fourteen items which can be found in Appendix A. Of major importance are the name of the business, the character of the business, the term of existence, the name and residence of each partner, and the contributions made by each limited partner. Substantial compliance in good faith with these requirements is all that is necessary for the fund to achieve legal recognition as a limited partnership law, any slight variation from the statutory requirements would render the limited partners subject to unlimited liability as general partners.

#### THE CATTLE FEEDING FUND: AN ILLUSTRATION

By a preliminary prospectus dated July 18, 1973, the Wheatheart Cattle Company announced its intent to register with the Securities Exchange Commission an offering of “interests” in limited partnerships to engage in cattle feeding. The limited partnerships are to be formed under the Texas Uniform Limited Partnership Act with an intended term of five years.

The minimum individual subscription is \$5,000. Subscribers must have either (a) a net worth exclusive of home, furnishings and personal automobiles of at least \$50,000, and a taxable income, some portion of which was in the last tax year, or based on the current year's estimated income will be, subject to federal income tax at the rate of 39% or more; or (b) a net worth exclusive of home, furnishings, and personal automobiles of \$100,000 or more. These prerequisites are known as "suitability" requirements and may be greater in some states.

The subscriber to this fund will have deducted from his subscription various charges referred to as the "front-end load." Eight percent (8%) of the gross proceeds of each fund formed will be paid as selling commissions to National Association of Securities Dealers (NASD) members. A maximum deduction of two percent (2%) of the gross proceeds will be used to reimburse the Wheatheart Cattle Company for expenses incurred by it in connection with the offering. These include legal, accounting, printing, and state and federal securities registration fees.

The total amount authorized by this registration statement is \$10,000,000. However, allowance is made for this amount to be divided among several limited partnerships, provided each has minimum subscriptions of \$250,000. The registration would allow as many as forty limited partnerships to be formed under this "umbrella" offering.

The managing class of partners, known as the general partners, consists of six individuals and one corporation. However, the corporate general partner, Wheatheart Cattle Company, is designated as the managing general partner. All six of the individual general partners are either directors or executive officers of the managing general partner. Wheatheart Cattle Company was incorporated in October 1970 under the incorporation laws of Texas and is wholly-owned subsidiary of Wheatheart Feeders, Inc. The corporate general partner serves as the managing general partner of nine limited partnerships formed between November 22, 1971 and May 18, 1973 for which aggregate realized subscriptions totaled nearly \$8,000,000.

For its management services, Wheatheart Cattle Company does not charge any set fee. Instead, the general partners will receive a profit share up to a maximum amount of 25% of the total capital contribution to the limited partnership if there are sufficient profits to make such payments after the limited partners have received distributions amounting to their original contribution plus an additional 100% of the original contribution. If there are additional funds after these distributions to the limited and general partners, such additional funds will be distributed 75% to the limited partners and 25% to the general partners.

Affiliates of the general partners, in contrast to the general partners, have substantial transactions with the limited partnerships giving rise to potential profits. The cattle can be purchased through a cattle order buying firm whose principal shareholder is a general partner. It is anticipated that a substantial portion, if not all, of the cattle will be placed in the feedlots of Wheatheart Feeders, the parent of the managing general partner. The limited partnership may be dealing extensively with Wheatheart Feeders in its feeding operations. There is a \$4 per ton milling charge together with a mark-up on feed sold not to exceed 20% of the "basic feed cost." Basic feed cost means the cost of the ration ingredients plus a \$4 per ton milling charge. As stated in the prospectus, "Wheatheart (parent corporation) and its affiliates expect to realize profits from such activities."

To leverage the contributions by the limited partners, the general partners intend to make arrangements with commercial banks to borrow funds equal to approximately one-half to two-thirds of the cost of the cattle, plus substantially all of the cost of the feed for the cattle. Such loans are anticipated to be two to three times the original

capitalization, but never to exceed four times the capital of the limited partnership at the time of such loan.

Should a limited partner wish to assign his interest, such assignment must take place on December 31 of each year. No consent for the assignment is required of the general partners. The assignee will only have the rights of his assignor to income and capital. No right exists to require any information or account of the limited partnership's transactions unless the assignee becomes a "substantial limited partner." The general partners' consent is required for recognition as a substituted limited partner.

A redemption procedure is provided by the limited partnership agreement, but a penalty of 10% of the value on the redemption date is imposed. Redemption can occur only on December 31, and written request on or before December 1 must be given the general partners. The settlement date will be "as soon as practical" after the cattle inventory has been liquidated.

No mention of a request or receipt of an IRS advance ruling of partnership tax status is made in the prospectus. Instead, an opinion of legal counsel is included, stating that in their opinion the limited partnership qualifies as a partnership for federal income tax purposes under the current Internal Revenue Code and Treasury Regulations.

## ADVANTAGES/DISADVANTAGES TO GENERAL AND LIMITED PARTNERS

### **The General Partners**

The major advantages in a limited partnership for the class of general partners include:

1. Management control unrestricted by equity contributions;
2. Availability of capital from the limited partner investors;
3. Opportunity to apportion the overhead of an existing organization (the general partner's corporate group) to the limited partnership;
4. Fuller use of organizational capacity, whether it be management or land holding facilities;
5. Less dilution or infringement of control compared to that exercised and required by large lenders (banks and other financial institutions); and
6. Development of expertise in the marketing of securities.

No doubt the availability of large capital amounts without management restrictions is a major attraction to the general partner fund. The alternative of going public as a corporation requires generally a history of successful business operations, a stable future for earnings potential, and a major selling effort that must reach hundreds, if not thousands, of investors. The limited partnership offerings do not often match any of these characteristics; rather, most funds are deemed highly speculative, risky ventures.

Most of these negative aspects of going public as a corporation are minimized by a limited partnership offering; although the federal securities laws impose the same disclosure requirements for limited partnerships as for corporations. First, the minimum size of the investment unit is usually large in comparison to stock purchases, ranging from \$2,500 to \$15,000. Secondly, limited partnerships are attractive to high income investors seeking a reduction in their tax liability. A trade-off between risk and tax shelter is conveniently available in the fund. Thirdly, since many limited partnerships or their general partners have little, if any, previous experience with such joint ventures, the SEC requirement of past operation disclosure fails to obstruct these offerings.

When coupled with the other enumerated advantages to a general partner, the factors of control and capital availability make a most enticing package for any management group. But, if everything is so easy and accommodating to the general partners, why don't corporations and proprietors convert into limited partnerships? Obviously, having certain possible advantages does not imply the absence of

disadvantages, and the general partners have their share, too. One disadvantage to general partners is the spectre of “unlimited liability” for partnership debts and activities. However, this is probably diminished as a menace by the employment of a corporation as the single general partner. The corporate general partner might have a net worth much less than the liability of the limited partnership. At least conceptually the imposition of unlimited liability upon members of the general partner class is a disadvantage.

Because the general partner is usually the promoter and organizer of the limited partnership, he is responsible for registering and obtaining securities clearance, as well as finding a market for the offering. This often is a major undertaking for the general partner, involving months of drafting and consulting with the SEC and printing and auditing are equally great. Even though this expense is met and the time-consuming process is completed, there remains the uncertainty of marketing the securities.

To assist in the selling effort, an underwriter is often employed. The underwriters should be advised as to the virtues and opportunities of the offering, and all his questions must be answered. More than that, the underwriter must be convinced that the offering is as good, if not better, than the many others offered him. Maintaining the enthusiasm and single-minded attention of an underwriting group is time consuming and expensive. Should no underwriter be employed, the promoters must establish their own network of contacts with potential investors, which can prove equally tedious and expensive.

If these are not enough impediments to slow down the scramble to become general partners, the thought of playing nursemaid to the numerous queries and visits of the limited partners may present a more formidable challenge. This is a necessary component of any successful limited partnership, both to keep the existent fund functioning smoothly and also to assure the general partner of a market for possible future offerings, if not for replacement funds for those terminating. These efforts go beyond the annual president’s report used by corporations to include quarterly, if not monthly reports on the fund’s activities, as well as timely tax information for use in the preparation of the limited partner’s individual return.

There are doubtless other disadvantages to being a general partner, yet the above discussion includes the major ones of unlimited liability and obtaining securities clearance. Another area of concern to the general partners is the possibility that tax reform legislation removing much of the shelter incentives for limited partnerships must be countered with lobby groups. This concern was evidenced in 1973 by the proposal of a cattle fund association to lobby against the Treasury Proposals for Tax Change introduced on April 30, 1973. Legislative threats are definitely a disadvantage to the general partner class in that they would do away with their “way of life” of management fees and affiliate dealings by making unsaleable present investment promotions employing the limited partnership.

### **The Limited Partners**

The limited partnership poses the following potential advantages for limited partners:

1. Tax Shelter;
2. Possible economic return on their investment;
3. Investment without management responsibility;
4. Limited liability;
5. “Schmaltz”

This listing is not necessarily all-inclusive, nor do investors seek out a limited partnership for all the various advantages. Rather all limited partners this study has been able to contact have indicated the possibility of reducing their federal income tax bite as the major, if not sole, motivation for investing in a limited partnership.

The potential of economic return, together with the likelihood of using “soft dollars” for the investment, is likely to rank as a major incentive for most limited partners. The advantage of little or no management responsibility can be attained to the same practical degree by stock investment, although technically, a stock-holder is deemed to exercise indirect management control by exercising his voting rights for directors’ elections. Tax shelter is the one advantage generally lacking in conventional stock investments.

As compared to the general partnership, the limited partnership enables the limited partners to restrict their liabilities to their contributions plus undistributed profits. This advantage is particularly relevant to potential investors when appraising the merits of high-risk ventures. Of course, a limited liability status could also be obtained by becoming a stockholder. However, the typical corporate investment would preclude the investor from the tax shelter advantages of a limited partnership.

Not to be discounted is what one spokesman for a cattle management group termed as “schmaltz,” i.e., the desire of investors to associate themselves with what they feel to be glamorous industries. This was evidenced in the Black Watch cattle breeding herds sold to the “Wall Street cowboys” during the late 1960’s. A related investor motivation is the opportunity to “tango where the action’s at.” This nebulous concept refers mainly to the real or imagined desire of all investors to capture the newness of an innovation or approach before other investors overcrowd the industry or legislative response lowers the boom on another lucrative loophole. The excitement allowed the well-heeled city investor by participating in an oil exploration venture, or owning together with other “club” members a lot of cattle, is difficult if not impossible to measure quantitatively. Assessing investor rationale for buying limited partnership interests. To discount this attraction of a limited partnership is most unrealistic, as any underwriter for such interests will likely admit.

The disadvantages facing limited partners are quite real, too, and include the following:

1. High management fees charged to the general partners;
2. Exposure to risks of economic loss;
3. Lack of rights to participate in management control;
4. Lack of a ready market for their interests in the fund;
5. Difficulty in guarding against and/or remedying unfair management practices that may be self-dealing;
6. The possibility that unlimited liability might be imposed should the limited partner be deemed to have participated in the “control” of the business; and
7. The collapse of promised shelter.

Perhaps the most immediate disadvantage thrust upon most limited partners is what is referred to in the investment industry as “front-end load,” i.e. initial management fees together with the organization and underwriting costs of the offering. Such costs have been known to reduce the original contribution by as much as 15% to 20%, much of which is nondeductible. These front-end loads increase the break-even rate of return so that to be profitable in an economic sense the limited partnership must yield return rates of as high as 15% to 25%. For the investor, this circumstance lessens the likelihood of recovering his original contribution, let alone of making a profit. Without a reasonable chance for profits the investor must put even more reliance upon the concept of shelter, a characteristic difficult to realize until the partnership has terminated.

An additional drawback for the limited partners is the likelihood of economic losses, whether caused by high input prices, low product prices, poor management, or some combination. The limited partner indeed subjects himself to more than the nebulous prospect of tax shelter.

## FEDERAL INCOME TAXATION AND THE LIMITED PARTNERSHIP

The limited partnership may be taxed either as a “partnership” or as an “association.” No one characteristic of organization will insure taxability under either classification. Instead, the determination of whether a limited partnership resembles a corporation more than a partnership entails analysis of many factors, especially those set out in the Treasury regulations. It is important to realize that the standards in the regulations are not the exclusive test of tax status. Other factors include the manner in which the business is conducted, its stationery and business letterheads, and the treatment by creditors and other businesses as to whether the association was regarded as a corporate entity or more like a partnership. Obviously, those “other” factors are less determinative than those contained in the regulations; however, caution is required to avoid overreliance upon the enumerated guidelines set out by the regulations.

The reason for the careful effort to avoid corporate taxation hinges upon the advantages to the investing partners when partnership tax status is available. The failure to achieve partnership tax status might be described as virtual disaster for a fund. This observation is most applicable to the limited partnerships organized in the tax shelter areas of oil drilling, real estate development, livestock feeding and breeding, vineyards, and nuts and citrus. A major attraction of these limited partnership investments is the allowance of partnership taxation to serve as a conduit for the various business deductions and operating losses from the business activities to the individual partners via the combination of cash accounting and deductible expenses. Through current expensing of operating costs under cash accounting, such deductions and possible losses are then available for application against non-partnership income of the investors, yielding a reduction in current tax liability. Should the partnership business be deemed by the Internal Revenue Service (IRS) to be more like an “association,” and therefore taxable as a corporation, the conduit pass-through is no longer available. Denial of partnership tax status will result in the deductions and operating losses being accounted for at the business entity level, not at the individual levels of the various partners. This amounts to the loss of “shelter,” and generally restricts, perhaps disastrously, the financial success of the limited partnership from the investors’ viewpoint.<sup>6</sup> In addition, corporate taxation would subject fund income to “double taxation” at both the corporate level and that of the individual “stockholder.”

Further note should be made of the possible divergent treatment given a limited partnership for federal income taxation purposes and for state recognition of the statutory limited partnership. It is quite possible that an organization may qualify under the state statutes as a limited partnership yet to be subject to “association” tax treatment. One classification is not dependent upon the other. This situation is apt to develop where a statutory limited partnership in compliance with a state’s adoption of the Uniform Limited Partnership Act (ULPA) does not exclude two or more of the “associational” characteristics outlined in the following discussion. The result is corporate tax treatment for the organization while liabilities, profits, losses, etc. are allotted according to the limited partnership statute and related partnership articles of agreement.

For federal income taxation purposes, taxation as a partnership is not limited to organizations qualifying under state law as partnerships. Such tax treatment also can apply to “syndicates, groups, pools, joint ventures and any other unincorporated organization through or by means of which any business, financial operation or venture is carried on but which is not a corporation, a trust or an estate.”<sup>7</sup> Nor are all “joint ventures” treated as partnerships for tax purposes, yet the joint involvement of several persons in a business for profit will normally result in a partnership for federal income tax purposes. It is somewhat more difficult to insure partnership tax treatment for the limited partnership, since some members (the limited partners) are not jointly involved in the business.

## **Associational Characteristics**

This difficulty in assuring partnership tax treatment for a limited partnership is a major concern in the organizational stage. The drafters of the limited partnership agreement must take heed in order to avoid the presence of too many corporate characteristics which would render the organization taxable as an “association” and not as a partnership. The criteria of corporate resemblance, derived from the court opinion in *Morrissey v. Commissioner*,<sup>8</sup> are:<sup>9</sup>

1. Associates;
2. An objective to carry on a business and share the profits;
3. Continuity of life;
4. Centralization of management;
5. Limited liability; and
6. Free transferability of an interest in the organization.

The first two characteristics are found in both partnerships and corporations, so that the association determination is made with reference to the remaining four which would normally be present in a corporation but not in a partnership. The absence of two or more of these corporate characteristics is therefore the criterion for partnership tax status. The structuring of the limited partnership in order that it will resemble more a partnership than a corporation is typically achieved by adherence to the following drafting precautions in the limited partnership agreement.

*Continuity of life.* The regulations state that a limited partnership formed under a statute corresponding to the Uniform Limited Partnership Act will not be deemed to possess this corporate characteristic.<sup>10</sup> The partnership agreement should not provide for the automatic continuation of the business upon the retirement, death, or insanity of a general partner, but should allow dissolution except where the remaining general partners or all remaining partners agree to continue the partnership.

*Centralized management.* The regulations provide that centralized management will exist ordinarily if substantially all of the interests in a limited partnership are owned by the limited partners.<sup>11</sup> For the agricultural limited partnerships examined (see Appendix B), the general partner seldom made nor was it required to make a significant capital contribution. Hence the corporate characteristic of centralized management is usually present.

*Limited liability.* This corporate characteristic is avoided where the general partners have substantial assets which could be reached by a creator of the limited partnership.<sup>12</sup>

*Free transferability of interests.* This corporate characteristic is present if any partner of those partners owning substantially all of the interests have the power without the consent of the other partners to substitute another person.<sup>13</sup> The partnership agreement should not provide for automatic acceptance of assignees as substituted partners in order to avoid this corporate characteristic.

Limited partnerships generally have little difficulty in drafting their partnership agreements to avoid two or more of the four basic corporate characteristics. Most easily avoided are “continuity of life” and “free transferability of interests.” Few agricultural funds examined made any significant attempt to avoid the “centralized management” aspect. Whether “limited liability” exists is now tested largely by the standards of Revenue Ruling 72-13 for purposes of advance IRS determination of a fund’s tax status.<sup>14</sup> It would essentially require a minimum net worth for a corporate general partner, based

upon the amount of total contributions to the fund. Few agricultural funds of the early 1970's have obtained advance rulings on their tax status, but neither do they run much risk that more than two corporate characteristics will be deemed to exist. The key to partnership taxation is basically cautious drafting of the partnership agreement in compliance with those provisions of the Uniform Limited Partnership Act given approval in the regulations.

### **Availability of Advance Rulings**

The service has made it more difficult for the limited partnership having a sole corporate general partner to obtain a ruling of partnership tax status by issuing Revenue Procedure 72-13. For many limited partnerships which rely upon the tax shelter appeal of their organization, failure to obtain such a ruling may retard selling efforts. This shortcoming is especially pertinent to those offerings of ventures with little or no prior history of business management and success. For the larger funds that have become established in the shelter industry, the advance ruling may not be so necessary. Organizations with a track record of several shelter funds are more likely to have developed a clientele from which to draw new ventures.

In addition to the problem raised by Revenue Procedure 72-13, offerings of limited partnerships, particularly the cattle feeding funds, have been stalled by the IRS from obtaining any advance ruling on taxability. The Service had been reluctant to issue any advance rulings pending a review at its national level of the policy for such appraisals. Finally in 1974 the IRS delivered a statement on guidelines it will use in deciding whether to issue advance rulings on partnership tax status. The effect of these guidelines is not expected to greatly increase the availability of advance rulings for tax shelter funds.<sup>15</sup>

The current practice if the offerings of limited partnerships is to have the legal counsel for the promoters issue a statement in the offering circular asserting that in their opinion the present offering meets all tests and guidelines posed by the regulations and the IRS, and should accordingly be afforded the tax status of a partnership. For example, the Western Trio Cattle Company made an offering of \$12,000,000 in limited partnerships in cattle feeding in a prospectus dated May 16, 1973. Under the section "Tax Information," the subject of an advance ruling was dealt with as follows:<sup>16</sup>

... it is the opinion of Fischman, Rosenberg, Kasmir and Willingham, Counsel to the General Partner, that under the current Internal Revenue Code and the Regulations the Partnerships to be organized hereunder will be regarded as limited partnerships and not as associations taxable as corporations.

A ruling was unobtainable for the Western Trio offering pending an IRS staff study as to what profit and/or capital interest the general partners must have.

At the present time, it is difficult to measure the effect on saleability of limited partnership interests caused by the lack of advance rulings. However, the number and size of the offerings of tax shelter limited partnerships has not been reduced by this uncertainty. Table 1 from The Commercial and Financial Chronicle indicates the substantial offerings registered with the SEC over the past several years.<sup>17</sup>

**TABLE 1. NATIONAL ASSOCIATION OF SECURITY DEALERS (NASD)–  
TAX SHELTERED FILINGS\*\***

Product	1970		1971		1972		1973 First Half	
	No.	Dollars Registered (\$1,000)	No.	Dollars Registered (\$1,000)	No.	Dollars Registered (\$1,000)	No.	Dollars Registered (\$1,000)
Oil & Gas	62	664,337	155	740,094	226	1,027,452	120	513,840
Real Estate	54	256,485	139	523,534	243	1,910,662	74	467,565
Farming	3	10,742	7	30,227	21	43,285	5	13,952
Cattle Feed- ing--Breed- ing	13	26,764	22	244,636	30	192,012	22	181,167
Miscellan.*	13	26,336	11	29,916	19	55,256	14	143,815
Total	145	984,665	334	1,568,406	539	3,228,667	235	1,320,339

\* Miscellaneous includes products such as: Cable TV, Auto Racing, Mining, Computer Leasing, Theatrical Productions, Restaurants, Commodities and many others.

\*\* Basically, a "tax shelter" is a business venture in which flow-through (conduit) tax benefits are a factor affording investors relatively large tax deductions. Such ventures are commonly in the form of a limited partnership.

### **The Partnership As a Conduit**

Obtaining partnership tax status is an accomplishment eagerly sought for the tax shelter investment program. Though the partnership is required to file a tax return, it is only informational (Form 1065).<sup>18</sup> Any income or operating loss is passed through in a conduit-like fashion to the individual partners. The partner, not the partnership, is the taxable entity. In a limited partnership, the limited partners would then be able "...to use against their individual incomes the partnership deductions and the losses which the partnership usually generates in the early years of its operation, losses which frequently are substantially greater than the capital invested by the limited partners."<sup>19</sup> The following discussion on federal income taxation will explore some of the major deductions used to constitute operation losses for write-off by the limited partners against their non-fund income.

### **Elections Affecting the Computation of Taxable Income**

According to Section 703(b) of the Internal Revenue Code (1954), most elections affecting the computation of taxable income must be made by the partnership, not by the individual partners. Examples of partnership elections under that section include the following:<sup>20</sup>

1. method of accounting;
2. taxable year;
3. depreciation methods;
4. additional first-year depreciation;
5. soil and water conservation expenditures;
6. land clearing expenses;
7. exploration expenditures;
8. intangible drilling costs.

For agricultural limited partnerships, many of the elections are specified in the written agreement, e.g., the partnership taxable year and the adoption of cash accounting. Advantage is gained by the careful selection of partnership taxable year, as it allows the inclusion or exclusion of high start-up costs in the partner's individual tax return if based upon a tax year which does not coincide with the taxable year of the investor. The advantages of being able to adopt the cash accounting procedure for limited partnership activities involving large amounts of deductible expenses are commonly glamorized by the promoters of cattle feeding funds and other agricultural offerings. Indeed, the availability of the accounting election has come under sharp criticism from the Treasury as well as from the industries affected, largely on account of the abuse generated by the practice of prepaying ordinary operating expenses. Allowance given farmers to currently expense what would otherwise have to be capitalized and offset other income through cash accounting has offered fertile territory to the nimble tax shelter promoters. Their prepayments were so widespread and successful in the citrus and almond promotions that Section 278 of the Internal Revenue Code was added by the Tax Reform Act of 1969, prompted largely by the industries affected. Originally, the section applied only to citrus farmers, but sufficient numbers of almond growers petitioned to obtain similar treatment under the new tax law. These growers were concerned that the flux of capital seeking shelter would increase almond supplies and adversely affect prices received. This section requires the capitalization of any expense attributable to the planting, cultivating, maintenance, or development of any citrus or almond grove which is incurred before the fourth taxable year beginning with the taxable year in which the trees were planted. In some of the remaining agricultural sectors, however, most offerings in the late 1960's and early 1970's have emphasized pre-paid expenses.

### **Prepaid Deductible Expenses**

A more current controversy relating to accounting methods employed by limited partnerships is the prepayment of certain expenses, notably feed and interest, to be deducted initially to produce operating losses that can be applied against the partners' other income. It is not the purpose of this study to discuss the development of standards of deductibility for such prepayments, as excellent articles are available for reference by the reader.<sup>21</sup> The deduction components relied upon include not only prepaid feed and interest, but also a heavy "front-end" load of management feed, legal services, office facilities, and other overhead expenses. The large amount of operating expenses and the opportunity to concentrate them in the early years are prime characteristics sought for tax shelter promotions via limited partnerships. The conduit principle of partnership taxation, together with an organizational structure suitable for a large public offering, make the agricultural limited partnerships most compatible for shelter promotions.

Normally a partner participating in an offering with a heavy dosage of initial expenses would be limited in the deductibility of partnership losses to the extent of his individual basis. Basis is a tax concept used to measure the extent of gains and losses, and is initially equal to the amount of contribution by an investor. Thus, unless other taxation provisions were available, an investor in a limited partnership would be unable to deduct his share of partnership losses, caused mostly by prepaid expenses, in excess of his investment contribution. These losses are not unusual for the start-up period because the partnership may often be losing money not only from the original investment but also money borrowed by the partnership. Fortunately for the shelter program, there are tax provisions available to surmount this potential limitation on deductions of partnership losses.

### **Nonrecourse Financing**

The existence of a basis for tax purposes greater than economic investment would warrant was first recognized in the case of *Crane v. Commissioner*.<sup>22</sup> In this case an individual taxpayer was entitled to include in his cost basis an amount equal to the mortgage placed upon the property. "Under the influence of *Crane*, the Code treats the loan to the partnership as a contribution to the partnership by one or another of its members."<sup>23</sup> The allocation among the partners of their increased basis on account of the mortgage is treated in the regulations.<sup>24</sup>

For a general partnership, each partner is personally liable for the partnership indebtedness, and is accorded a pro rata increase in the basis of his partnership interest. Similar treatment of basis allocation results where the loan is secured by a lien only on the mortgaged object, e.g., real estate. In a limited partnership, on the other hand, the limited partners are liable for business obligations only to the extent of their stated contributions and share of undistributed profits. Liability for loans in excess of these base amounts must be imposed upon the other class of partners, the general partners. Since the limited partners do not assume liability for default on loans, general tax principles would deny any increase in their basis for loans made to the limited partnership. Absent provision in the regulations, the limited partners would be unable to deduct 150% to 200% of their contribution in the first year without assuming personal liability for the indebtedness as a general partner.

However, the regulations provide for the allocation of a loan liability basis among the limited partners, where none of the partners are subject to personal liability on the mortgage. The relevant regulation provides:<sup>25</sup>

Where none of the partners have any personal liability (as in the case of a mortgage on real estate acquired by the partnership without the assumption by the partnership or any of the partners of any liability on the mortgage), then all the partners, including limited partners, shall be considered as sharing such liability under section 752(c) in the same proportion as they share the profits.

The indebtedness referred to in the regulation above is commonly known as the nonrecourse loan. Nonrecourse loans must look exclusively to the mortgaged collateral for satisfaction of the indebtedness should default occur. Neither the limited partnership nor any of its two classes of partners assume any of the liability for the loan. For example, a nonrecourse mortgage on real estate can be acquired by the limited partnership without the assumption of liability by the partnership or any of its partners. The mortgagee (lender) must look solely to the real estate for the payment of the mortgage. In this situation, each partner is allowed to add his share of the partnership's liability on the mortgage to his basis. Thus, the promoters of tax shelter limited partnerships are able to leverage their investors' contributions with a combination of nonrecourse financing and a heavy front-end load so that the limited partner is able to deduct during the first year of partnership operation an amount larger than his contribution, without incurring personal liability for the financing. Spectacular as this may appear to the investor, the gimmick does have its disadvantages. For example, the interest charges for nonrecourse financing are usually 1% to 2% higher than the conventional, recourse financing. The lender is likely to place more limitations on how the money can be used and to demand detailed interim reports on the status of the investment. Simply obtaining the necessary amount of such loans might be a major obstacle.

### **Organizational Expenses**

A partnership, unlike a corporation (see Section 248, Internal Revenue Code of 1954), cannot deduct or amortize its organizational expenditures. In the sale of limited partnership interests, the agreement normally provides wither for the legal auditing, printing, and underwriting expenses to be deducted from the investors' initial

contribution to arrive at their net investment, or for the promoters to recoup their organizational expenditures through management fees and/or profit interests. Nevertheless, there are hints or inferences that there have been successful attempts to deduct these expenses. The leery investor would certainly not regard the expenses of organization as a likely source of significant deductions against his non-partnership income.

The limited partnership is a most useful investment vehicle, provided the tax status of an association can be avoided and the careful drafting and management of the deductible items and financing arrangements are adequately provided for. However, the zeal of promotion has led to rather common and frequent abuses, and both the industries affected and the Treasury have raised their eyebrows in concern. The next section of this research report will discuss some of the reasons and measures for the extent of investment in agricultural enterprises via the limited partnership, together with an appraisal of the influence of reform efforts directed at such investments.

## PROPOSALS FOR RESTRICTING FUND INVESTMENTS IN AGRICULTURE

### **Internal Revenue Service and the Funds**

The Internal Revenue Service (IRS) is the primary enforcer of the government's tax laws, and is frequently the focus of comment by the limited partnership promoters. Cattle feeding funds are almost totally dependent upon prepayment of feed to afford a loss write-off for limited partner investors. Other limited partnership shelters emphasize prepaid interest, management fees, and any other operating expense which the promoters believe capable of withstanding challenge by the IRS. Prepaid feed has been on the hot items list of the IRS for many years, being a frequently disputed deduction allowance. The status of this feud is unsettled as courts reach varying decisions as factual contexts change; however, the IRS has recently lost a battle to disallow a hog farmer's prepayment of feed in Iowa.<sup>26</sup> Perhaps because of this impetus, the IRS softened its stance on prepaid feed somewhat in a Memorandum of Technical Advice in 1973 to Western Beef of Amarillo, Texas.<sup>27</sup> In this Memorandum the IRS outlined the conditions under which prepaid feed might be allowed as a deduction, giving credence to the thought that the Service might be more willing to await Congressional actions on tax shelters in general. Though such sentiments might bring a sigh of relief to the limited partnership promoters, only time will determine whether the IRS has truly resigned itself from the offensive in the prepaid feed arena in favor of the tantalizingly slow action of the Congress. The embodiment of the Western Beef Memorandum in a proposed revenue ruling (73-530), issued in conjunction with an IRS challenge of prepaid feed in Oklahoma by the Western Heritage Cattle Funds of Guymon, Oklahoma, shows the IRS has not withdrawn. The IRS listed several criteria to be met before prepaid feed would be considered deductible, including a test that the prepayment must not "materially distort income." The IRS has never before been successful with this criterion in its challenges to prepaid cattle feed. The authority of the IRS to issue such a test, in view of its lack of success in previous court decisions, was challenged by the feedlot concerned and the Cattle Feeders Tax Committee, with the result that the District Court of Oklahoma City threw out the test of material distortion of income for prepayment of feed by restraining the issuance of the ruling. As of February, 1974, this court holding was being appealed by the IRS, with the Court of Appeals (Denver) having granted a stay of the lower court's holding until a final decision is reached by the appellate court.<sup>28</sup> This legal skirmish would seem to suggest that the IRS will not await Congressional action against tax shelters involving prepayment of feed, although it certainly would welcome an ally at this time as the courts have declined to endorse the recent Memorandum completely.

The IRS is also the challenger of fund claims that their limited partnerships have attained a tax status of partnerships and not associations. This area of challenge has not been frequently explored by the IRS. However, the 1973 court holding in the *Mann* case favoring the taxpayer might only be a signal for the Service to shift its emphasis to the associational characteristics present in the limited partnerships. The fund promoters, however, are protected by a relatively lengthy period of passive acceptance of the partnership tax status claimed by those limited partnerships formed in compliance with the model version of the Uniform Limited Partnership Act. In addition, the Treasury regulations even help out the funds by declaring that a limited partnership formed in a state adopting the uniform act shall be considered as *not* possessing the associational characteristic of continuity of life.

### **Proposals for Tax Change-April 30, 1973**

The securities regulators and the IRS have not been alone in their challenge of tax shelters directly, and limited partnerships indirectly. The Nixon Administration delivered its version of tax reform for shelter ventures on April 30, 1973. The proposals embodied more than just an attempted revision of tax shelters. Some critics would argue that the Treasury proposals would eliminate or seriously damage the funds in various industries.

The section entitled "Limitation on Artificial Accounting Losses" (LAL) is more specifically directed towards the tax shelters that include agricultural funds. LAL is designed, as stated in its preface, to eliminate tax shelters, defined:<sup>29</sup>

...as investment devices by which an individual obtains an immediate and usually substantial reduction in the amount of tax on income he already has and upon which he would but for obtaining the 'tax shelter' have to pay tax...Such devices take advantage of basic tax accounting rules as well as intended tax incentives which contemplate some deferral of tax, but which need not be permitted to create an artificial loss.

LAL would create a special account, called Deferred Loss Account (DLA). DLA would accumulate all artificial losses which would then be applied as a deduction in a succeeding tax year against available net related income or taken into account upon sale or other disposition of the property to which the deferred loss is attributable. An artificial accounting loss is defined as follows:<sup>30</sup>

...that portion of any loss, attributable to an activity or related activities, which would disappear if the taxpayer had no accelerated deductions in the current year. An accelerated deduction is a deduction which clearly relates to some future expected profit and has little or no relation to income reported in the current year.

Agricultural tax shelters principally involve accelerated deductions for prepaid feed or other expenses relative to crops or livestock which will not produce income until a future time. The LAL provision was said to be directed at tax shelter operations and not at ordinary farmers. A recent appraisal of the Treasury Proposals by a task force of the Council for Agricultural Science and Technology (CAST) suggests the LAL Proposals would leave unaffected the ordinary farmers mostly because the provisions would be ineffective in curbing tax shelter operations in general.<sup>31</sup>

The Treasury Proposals were written in general and often vague language. The spirit of tax reform was in evidence, yet the mechanics of reform were left largely unstated. Were these proposals to be adopted as written, considerable maneuvering room would still be left the gimmick-prone promoter. The Treasury Proposals were not dealt with in any substantial form by the Ways and Means Committee in 1973 or 1974. The mood of the country reflects more a concern for adequate housing and energy supplies. The inequities of the tax system remain in the background until a less crisis-enveloped moment in history.

Should effective tax reform falter, fund promoters are likely to continue their expansion oriented approach in organizing limited partnership to serve as tax shelters both in agriculture and elsewhere. Any significant hindrance to the growth of public limited partnerships in agriculture probably will depend upon the challenges by the IRS over the deductibility of prepaid operating expenses, with some assistance perhaps from the Securities Exchange Commission and the state securities commissioners by their stiffening of registration and qualification requirements for tax shelter offerings. Neither of these restraining influences is foreseen as capable of completely blocking the usage and expansion of funds in agriculture. The courts have not shown unquestioning support for the IRS's challenge towards prepaid feed, most recently noted in the *Mann* case and the Memorandum challenge over the material distortion of income criterion. The securities regulatory agencies operate within a framework of insuring full disclosure to the investing public, so that once the conflicts of interests are disclosed with a general note on the substantial risks of leveraged cattle feeding, the promoters are essentially free to proceed unhampered by the security regulatory agencies. The limited partnership promoters have gained much more experience and acumen in registering agricultural offerings with the Securities Exchange Commission and the various state securities commissioners. There is little reason to doubt such promoters would be able to comply with additional formulae requirements in the full disclosure process.

The most limiting obstacle to the public limited partnership in agriculture will perhaps be its need for sustained economic profits under a heavy load of front-end management fees and selling expenses. The question remains how much impact a bad year will have upon future promotions of limited partnership interests. The current large losses in cattle feeding funds will provide one test as to investors' willingness to reinvest after adversity.

#### ADOPTABILITY OF THE LIMITED PARTNERSHIP IN AGRICULTURE

The limited partnership has become the favorite financing vehicle of promoters for various agricultural ventures. While public limited partnership offerings in cattle feeding have been hindered by the 1974 losses in cattle funds the proliferation of limited partnership offerings is likely to continue.

The opportunity to organize ventures utilizing the limited partnership poses some interesting questions for those agricultural firms needing large amounts of capital, either for expansion of existing operations or simply to replace their own thin capitalization with that of outside investors. Promoters of existing and potential limited partnerships must live with the possibility of tax reform, fluctuating economic returns, and the usual costs and delays in marketing the packaged limited partnership interests to widely dispersed clients. Each given industry presents its own set of circumstances for the promoter to understand and control before his fund will surface. Yet in spite of Internal Revenue challenges to prepaid expenses (particularly feed in the cattle funds), Treasury tax reform proposals, and mustering of tax shelter critics in Congress, limited partnerships are being filed for registration with the Securities Exchange Commission by both new and existing funds. There seems to be a feeling among the adopters of the limited partnership on agriculture that whenever and however tax reform does appear, it will not strike as hard against existing limited partnerships compared to those seeking to utilize the limited partnership for the first time.

#### **Extension of Funds to Other Agricultural Sectors**

The limited partnership is already utilized to some extent by firms in the agricultural sectors of cattle feeding, cattle breeding, egg production, citrus groves, nut trees, vineyards, and special combinations referred to as "general farming" by the promoters (combination of activities in citrus, nuts, vineyards, vegetable crops, and

sometimes grain crops). Agricultural offerings to date have emphasized their tax shelter potential, whether capital gains treatment or simply tax deferral (see Appendix B for a listing of selected agricultural funds).<sup>32</sup> Consequently, the availability of deductible expenses during the start-up period of a business is a prime factor for potential adopters of the limited partnership. Furthermore, the deductible expenses generally must either be capable of being bunched at the end of a taxable year or be associated with start-up expenses. The substantial expenses incurred during the development stage might be either immediately deductible as ordinary operating expenses or deductible as depreciation over the appropriate life of the assets if capital assets are being created. Because not all agricultural operations lend themselves to a bunching of ordinary operating expenses or have large start-up costs allowing large write-offs with depreciation, the limited partnership is not equally attractive or as feasibly utilized by all agricultural firms.

Even where large amounts of deductible expenses might possibly be bunched to create an operating loss for some taxable years, other considerations operate to retard the adoption of the limited partnership in such agricultural sectors. For example, field crops would seem to offer sizable amounts of deductible operating expenses in fertilizer, seed, gas and machinery, yet this sector has not been a site for the spawning of limited partnerships. The fewness of corporations large enough to float a fund in field crop production may explain the sparcity of non-farm investment ventures. Another suggested explanation for the lack of limited partnership funds is the threat of potential public protest against the entry of large amounts of outside capital in the operation of large-scale farming units which might be said to threaten the existence of the smaller firms surrounding the super firm adopting this financial vehicle. Whatever rationale one employs to explain the lack of limited partnerships in such agricultural sectors as field crops, it cannot be denied that more than just deductible expenses are necessary for the success of a limited partnership offering. Nonetheless, the types of expenses-whether they are manipulable, their magnitude, and their recurrence-are definitely factors in the successful merchandising of a limited partnership in agriculture.

Another factor relevant in considering whether the limited partnership might be adopted by a farm firm is the need for capital-both the magnitude required and the period involved. This is not to imply existing credit is unavailable or insufficient through traditional sources where firms already utilize the limited partnership. Rather, the limited partnership allows another capital source, the outside investors, to undertake the bulk, or at least part, of the responsibility or providing risk capital. Of course, businesses more prone to consider the limited partnership as a source of risk capital are those planning to expand operations to levels that might exceed the liquidity requirements of the traditional capital sources. There is no denying that American agriculture had become a capital-intensive industry, though more in some sectors than others. To provide the necessary equity base in order to attract the complementary offering of debt capital, large farm firms in various sectors are considering the limited partnership as one alternative to facilitate the acquisition of additional equity capital.

Given the requisite factors of a large capital requirement and the availability of large start-up expenses, the environment for a limited partnership is almost lifeless without the presence of another factor: financially sophisticated management. Sophisticated management refers to that type of management ability capable of utilizing the skills necessary in organizing and successfully promoting and operating a legal entity as the limited partnership. If the management does not itself have accounting and legal ability, it must know where and how to obtain it. Management willing and able to cope with the complexities of large-scale financing activities is required. These activities include the conceptualization process characteristic of the relevant securities filing with the Securities Exchange Commission and the state blue sky commissioners, the provision

for a network of broker-dealers and underwriters, and the continuing ability to smooth many irregularities and to maintain harmony among so many diverse investors. The mere legal mechanics of qualifying an offering of limited partnership interests for registration with the relevant securities agencies, both federal and state, involve generally three months and \$50,000 at the minimum, and sometimes more than six months and a cost of upwards of \$150,000.<sup>33</sup> Unless the fund is successfully launched, these preparation expenses involved in registration and organization will be borne solely by the promoter groups, which is a fairly substantial risk for a management group to undertake where it has little or no previous familiarity with security offerings. What firms in agriculture today have what has just been labeled as sophisticated management? Perhaps not even all existing limited partnerships in agriculture have this important factor. Obviously, a firm familiar with large-scale financing and/or the corporate form of business organization might be more likely to possess such management ability. Indeed, existing limited partnerships in agriculture frequently have corporate general partners as the sole manager of the fund. These corporate general partners are themselves often subsidiary offshoots of larger, more complicated corporate organizations. However, the corporate general partner need not be large by non-agricultural firm standards in order to possess the drive characteristic of sophisticated management. Corporate agricultural firms seeking the command of additional risk capital for their own purposes, ready, willing, and able to apply themselves to the intricacies of fund promotion and operation, have commonly been the driving force in the numerous cattle feeding funds offered in the 1970's. Typically, they have been large by agricultural standards but small by industrial standards. That their management would possess a higher degree of sophisticated ability than that of the family farmer operating as a sole proprietorship is to be expected.

In spite of these seemingly unique requirements for the adoption of the limited partnership by a farm firm, the limited partnership has been and will likely continue to be a viable instrument for obtaining equity capital in agriculture absent any substantial and abrupt change in the federal income tax environment or major economic failure of the funds. Some agricultural sectors might be more suitable for the limited partnership than others. These sectors include broilers, eggs, and turkeys. These commodity areas are suggested as prime candidates for the successful use of the limited partnership because they possess varying degrees of the above mentioned characteristics: (a) large capital requirements; (b) manipulable operating expenses or large start-up costs; and (c) the presence of financially sophisticated management. In an egg limited partnership there are large amounts of prepaid interest, feed, medication and services that could make up the write-off feature. In addition, the egg-laying bird is considered to be a deductible expense. Broilers would seem to present many of the same opportunities to structure a successful fund. Assuming most broiler production is by contractual arrangement, as is much egg production, the large feed companies and/or processing firms contracting with the grower likely have management capability to provide the necessary legal, accounting, and other expertise, along with the initial cost outlay for organization and registration, to successfully create a limited partnership to provide equity capital for replacement and/or expansion purposes. Perhaps the lack of adoption of limited partnerships by the broiler management groups has been attributable to a satisfaction with previously existing capital arrangements. Should there be a tendency for existing firms in the broiler sector to expand their operations suddenly, the limited partnership would seem to be a prime vehicle for financing. If the 1970's continue to bring rising costs for the large amounts of inputs employed in broiler production, together with volatile product prices for the broilers, profit margins likely will induce a reconsideration of existing risk taking and capital supplies. Many of the limited partnerships examined had management groups seemingly quite satisfied to earn management fees and related service fees while the limited partners subjected their capital to the risks of production and marketing. The

limited partnership would seem to meet the needs of both the expansion-minded entrepreneur and the firm desiring to subject someone else's capital to the risks of the business.

What was said for the egg and broiler sectors might transfer readily to the turkey sector. Turkey production is also undertaken largely via contractual arrangements, primarily with feed companies. Management in the feed companies probably has the requisite acumen to create, sell, and operate a limited partnership. The expenses for feed, insurance, medicine and related management fees certainly would create a sizable write-off for the turkey fund limited partners.

Would any other livestock enterprise be a good candidate for adoption of the limited partnership? Would hogs be an agricultural sector where firms need large amounts of capital?

The prospects until now for limited partnerships in hog production have not appeared bright. The reasons have included the following: (a) disease control for large-scale confinement farrowing operations has been a serious problem; (b) there were few examples of large production units approaching the scale required to utilize the funds accumulated or to warrant the expenditures that accompany the successful formation and operation of a limited partnership; and (c) the management sophistication to run large-scale hog operations was either fully employed already or else didn't exist in sufficient amounts to assure the successful operation of a hog fund. However, numerous corporate confinement farrowing units of large size have been begun since 1970. Moreover, information is becoming available on many large hog feeding operations, including large farrowing operations which have operated successfully for several years.<sup>34</sup> Thus there may now or soon will be several firms in hog production which have an interest in limited partnerships and the economic size and managerial sophistication to utilize them profitably.

Implementation of the limited partnership form of organization to acquire large amounts of outside capital will require substantial outlays for the costs of forming and selling the security interests. Accordingly, many farm firms might be said to be discouraged from adopting the limited partnership on account of this barrier to entry. Although capital requirements are commonly said to be increasing for most, if not all farm firms, the capital needs of some agricultural sectors are probably adequately met with traditional sources of capital. For example, the dairy sector is not immune to the rising cost of feed, machinery, and labor, yet dairy firms by and large have opted to meet these increased capital demands either through internal financing by the farmer himself or through borrowing from local credit sources. The increased capital requirements have not occurred overnight nor have dairy firms been subject to a string of bad years. Neither have dairy firms sought to expand rapidly, so that any increased capital needs are more predictable and met with internally generated capital. Moreover, such firms typically own their major resources as land and milking facilities and have developed good credit bases for incremental expansion of their operations.

In both the hog and dairy sectors there is developing some degree of leasing activities of sows/boars and cows. The extent of such activities is unknown; however, their impact as to the likelihood of the adoption of the limited partnership in such sectors is likely to be favorable, as leasing development suggests a lack of equity capital by the traditional farmer or at least an unwillingness to finance further expansion himself. Perhaps more than anything else, leasing arrangements indicate a willingness of the production system to experiment with alternative financing means, which makes the limited partnership next in line for consideration.

Another agricultural enterprise meriting a high rating for potential application of the limited partnership is domestic fish farms, notably catfish. The confinement environment for fish farms presents a situation much like that for cattle feeding and swine,

i.e., the potential exists for sophisticated management to promote fish farms via limited partnership interests by emphasizing the ability to bunch operating expenses as feed and medicines to yield large first-year write-offs. A promotion factor lacking in hog, broiler, or turkey production is tantalizingly present in the fish farm industry: schmaltz. Schmaltz is commonly used to imply an element of irrational exuberance portrayed by investors when describing their particular investment in club rooms or at social gatherings. Investment advisers have succeeded quite well in selling cattle feeding limited partnership interests to investors on Wall Street (“Wall Street cowboys”), with much credit given to the associated “schmaltz” appeal. A fish farm venture might provide an investor with a similar portion of schmaltz, given the uniqueness of this new industry.

This listing of agricultural commodities where limited partnerships might be feasible is suggestive rather than exhaustive. The authors lack the necessary familiarity with many specialty crops and products to make any assessments. Moreover, conditions can change rather rapidly. Even an area like Midwestern field crops may be found to be attractive to sizable corporate interests utilizing the limited partnership.

### **Common Denominators**

Theoretically, the limited partnership could be adopted by any farm firm at least from the standpoint of using it as a legal entity. However, its usage as a drawing card for financing requires much more than mere compliance with the enabling statutes for formation. The above discussion focused upon the factors of capital requirements, manipulable expenses, and sophisticated management. Each of these factors must be qualified within the context of the particular agricultural sector, if not for the particular firm itself. To focus exclusively upon these three factors is not realistic; undoubtedly, there are other factors to consider in predicting the suitability of the limited partnership for a firm. What is true for the cattle feeding industry is not always equally valid for the hog sector, and vice versa. But what must be said is that the public limited partnership has come of age and that it is capable of threatening traditional financial and organizational forms in agriculture.<sup>35</sup>

### **THE IMPACT OF LIMITED PARTNERSHIPS UPON AGRICULTURE**

Agriculture is a collection of widely-scattered firms engaging in myriad activities in a multitude of size and commodity combinations. To state with assurance that one influence, as the limited partnership, is the sole cause of a particular condition or result is to pretend that the world is made up of unidirectional relationships, free from the complexity of social, legal, and economic interaction. Nevertheless, the impact of limited partnerships upon agriculture need not be said to be without consequence. Funds have facilitated the introduction and/or expansion of large-scale production facilities beyond the scale traditionally associated with the family farmer, as well as beyond the reinvestment path of non-public farm corporations. Estimates of non-farm equity capital in cattle feeding in early 1974, for example, range from \$150 million to over \$400 million, representing as much as 20% of the fed cattle industry.<sup>36</sup> The 2-% estimate includes all outside capital, thereby including other than solely limited partnership funds. Whatever the estimate be for the funds in cattle feeding, it cannot be denied that limited partnerships have contributed substantial equity capital to that industry.

### **Structural Changes**

The limited partnership has contributed to the formation and growth of larger firms in the cattle feeding industry. Firms utilizing funds have been able to utilize more fully their existing feedlot capacity, to expand existing lots, and to acquire more lots until now the multi-lot cattle feeding firm is becoming common. Capacities of these “super firms” now reach and exceed 100,000 head. Much of this growth activity has occurred

simultaneously with the adoption of the limited partnership by these firms. The limited partnership has been seized upon by these entrepreneurs as an opportunity to achieve rapid growth; the results have accentuated the shift in the location of the fed cattle industry from the farmer feedlots of the Midwest to the domain of the super firms with funds in the High Plains and Southwest. As the structure in the cattle feeding industry shifts from one made up of numerous small- to medium-sized feedlots to one made up of fewer firms with much larger feedlot capacities, previously existing market relations begin to break down. Such related industries as slaughter and processing plants, grain suppliers, and trucking services are attracted towards the location of the larger firms.

The presence of large firms with fund money presents a different slant to profit motivation. Under a fund arrangement, most feedlot firms derive their returns from charging management fees for their services, together with feed markups, feedlot charges, and perhaps a share of the profits upon termination of the fund. All these avenues for compensation minimize greatly the risk capital of the feedlot and its subsidiary: the fund management. The feedlot firm operating with a fund arrangement is a cost-plus operation, generally empowered by the fund articles of agreement to pay a competitive price for feeder cattle, feed, medicine, etc., without lessening fees to be paid to the general partner managers.

Fund capital, sometimes referred to as “funny money,” is contributed by high tax bracket investors. Their capital, if successfully applied to operating losses, represents an “IRS loan.” As long as the venture does not lose money when the operations are finally terminated and contributions are returned, the investor has simply taken money he ordinarily would have paid to the government as federal income taxes and delayed his tax liability until the fund terminates. He then receives back his capital, again subject to federal income tax liability, unless another fund is employed to continue the tax deferral. The fund management receives contributions from investors who in effect receive an interest-free loan from the government. Such investors are not so demanding that they receive a minimum return on “their” investment, as the investment is really being sponsored by the government. Capital obtained from such investors presents a significant advantage to fund management over other firms, corporate or otherwise, whose capital suppliers are more demanding that an economic pre-tax return be forthcoming. In the cattle feeding industry, both the family feeder and the corporate feedlot operating without tax-benefit capital are disadvantaged relative to the fund feedlots. The feedlot firms without tax-benefit capital, including the family feeder and other forms of corporate financing, are put at a competitive disadvantage in obtaining financing.

Inability of commodity prices and outputs is likely caused by a sizable introduction of limited partnership capital. There are two causes. During a period of good returns, an investor may want to reinvest all his earnings (and even invest more) rather than end his deferral and pay income taxes. For example, in cattle feeding there was evidence of a pyramiding of investments up to the market crash of 1974. On the other hand, since the crash such investors have been less willing to feed cattle than have experienced farmers and feeders. Secondly, the general partners controlling a flood of year-end funds and desiring to fill their feedlots could hardly be expected to heed the warning signals that feeder cattle were being bid too high in the fall of 1973.<sup>37</sup>

Similar developments are believed underway in the egg industry as evidenced by recent public registrations of funds by two egg firms, for a total of \$9.2 million in registered limited partnership interests. One of the egg funds is a sequel to a successful offering of \$3 million in limited partnership interests in December, 1972. Large influxes of equity capital cannot but have an impact in an industry characterized with a history of fluctuating prices and varying production levels. The independent egg producer will be at a disadvantage in trying to survive when rivals operate on a cost-plus arrangement, all

the while assured of substantial capital availability for the duration of the fund (approximately five years).

The creation of a stratum of super firms within an industry allows for the formation of a new voice, pitched at a level often more comforting to the interests of the bigs than that of the smaller firms. Funds recognize the potential threats challenging their reliance upon funny money. Accordingly, they are likely to undertake public image campaigns to soften the impact of the clamor for tax shelter reform and to stimulate a feeling of common interest among the whole industry, whether large or small firm. The politics of numbers and money would seem to favor the expression of super firm philosophy, for the limited partner numbers are likely to grow into a segment rivaling the political voice of smaller firms. Any likelihood of counterattack by the smaller forms would depend largely upon the similarity of interest aroused in the general populace against tax shelters. Tax reform advocates, IRS, and Securities Exchange Commission are no doubt strong allies for such a confrontation.

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<sup>1</sup> *Evaluation of the U.S. Treasury's Proposed Limitation on Artificial Accounting Losses and the Potential Impact on U.S. Agriculture*, prepared by a task force for the Council for Agricultural Science and Technology (CAST), November 5, 1973, p.10. (Hereafter referred to as CAST Report.)

<sup>2</sup> Agricultural tax shelters are also available via the subchapter S corporation and agency agreements. For a discussion on the subchapter S corporation in hog production, see *Who Will Sit Up With the Corporate Sow?*, a report on vertical integration and large-scale hog production in Nebraska, prepared by the Center for Rural Affairs (1974). Agency agreement investments are most often available in cattle feeding and breeding.

<sup>3</sup> Joseph Taubman, "Limited Partnerships," 3 *Corporate Practice Commentator*, 15 (1962). For a reference on the historical usage of the limited partnership in England, see Viscount Halsbury, General Editor, *Halsbury's Laws of England* (London: Buttersworth and Company, Ltd., 1937), Second Edition, Volume 24, note (r), p.518, indicating that the 1907 English statute (7 Edward 7, Chapter 24, Section 4) on the limited partnership "...for the first time rendered it possible for a person to become an actual partner in a British mercantile firm, upon the terms that his liability to the creditors of the firm shall be strictly limited, like that of a shareholder in a limited company, to a fixed amount, representing the capital invested by him in the business."

<sup>4</sup> *Ames v. Downing*, 1 Bradford 351 (New York 1850).

<sup>5</sup> William Draper Lewis, "The Uniform Limited Partnership Act," 65 *University of Pennsylvania Law Review* 716 (1917).

<sup>6</sup> John S. Pennel, "Tax Considerations in Organizing a Partnership," 1973 *University of Southern California Law Center Tax Institute* 334.

<sup>7</sup> *Ibid.*, p. 336.

<sup>8</sup> 296 U.S. 344 (1935).

<sup>9</sup> Treasury Regulations, Section 301.7701-2 (a).

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- <sup>10</sup> Treasury Regulations, Section 301.7701-2 (b) (1).
- <sup>11</sup> Treasury Regulations, Section 301.7701-2 (c) (1) and Section 301.7701-2 (c) (4).
- <sup>12</sup> For the situation where a corporation serves as the sole general partner, see Note, “Can a Corporation Be a Partner in Texas?” 24 *Baylor Law Review* 210 (1972); Bernard Stein, “Partnership Taxation for the Limited Partnership with a Corporate General Partner-It Can Be Done,” 25 *University of Miami Law Review* 435-449 (1971).
- <sup>13</sup> Treasury Regulations, Section 301.7701-2 (e) (1).
- <sup>14</sup> Revenue Procedure 72-13, Internal Revenue Bulletin 1972-2, p.26.
- <sup>15</sup> Revenue Procedure 74-17, issued May 16, 1974. The availability of an advance ruling will depend upon the following four requirements:
1. The interests of all general partners, taken together, in each material item or partnership income, gain, loss, deduction or credit must be equal to at least 1% of each such item at all times during the existence of the partnership. Limited partnership interests owned by general partners don’t count for this computation;
  2. Aggregate deductions claimed by partners as distributive shares of partnership losses for the first two years of operation can’t exceed the amount of equity capital invested in the limited partnership;
  3. Creditors making nonrecourse loans to the limited partnerships can’t acquire, as a result of the loan, any direct or indirect interest in the profits, capital or property of the partnership other than as a secured creditor;
  4. Rules concerning the above requirements must be contained in relevant documents furnished with the request or by factual representations that they’ll be contained in all relevant documents when finalized.
- <sup>16</sup> Prospectus submitted to the Securities Exchange Commission, entitled “Western Trio Cattle Company,” dated May 16, 1973, p. 42.
- <sup>17</sup> *The Commercial and Financial Chronicle*, July 26, 1973, p. 15.
- <sup>18</sup> Internal Revenue Code of 1954, as amended, Section 701.
- <sup>19</sup> Pennell, p. 366.
- <sup>20</sup> James A. Hewitt and John S. Pennell, “Practitioner’s Guide to the Taxation of Partnerships and Partners,” 38 *Journal of Taxation* 159 (1973).
- <sup>21</sup> The reader is referred to Charles A. Pinneym Jr., “Agricultural Tax Problems Including the ‘Prepaid Feed’ Controversy,” 1973 *University of Southern California Law Center Tax Institute* 477.
- <sup>22</sup> 331 U.S. 1 (1946).
- <sup>23</sup> Richard A. Epstein, “The Application of the Crane Doctrine to Limited Partnerships,” 1972 *University of Southern California Law Center Tax Institute* 105.
- <sup>24</sup> Treasury Regulations, Section 1.752-1 (e).

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- <sup>25</sup> Ibid.
- <sup>26</sup> *Mann v. Commissioner*, 483 F.2d 673 (8<sup>th</sup> Cir. 1973).
- <sup>27</sup> The contents of the Western Beef Memorandum were restated in the proposed Revenue Ruling 73-530 (November 1973).
- <sup>28</sup> For comment on the challenge to proposed Revenue Ruling 75-530, see “Cattle Feeders Tax Committee Wins IRS Suite,” *Calf News*, January 1974, p.1; “IRS Appeals Prepayment Decision,” *Calf News*, February 1974, p.1; Michael F. Klein, Jr., “Treasury’s Prepaid Feed Ruling: Tough New Tests and Retroactivity Raise Questions,” 40 *Journal of Taxation* 96 (1974).
- <sup>29</sup> *Proposals for Tax Change- April 30, 1973*, Department of the Treasury (Washington: U.S. Government Printing Office, 1973), p. 94.
- <sup>30</sup> Ibid., p. 97.
- <sup>31</sup> CAST Report, pp. 7-8.
- <sup>32</sup> While most cattle feeding funds of the early 1970’s emphasized the potential for income tax deferral, more recent cattle feeding funds sometimes offer the prospect of converting ordinary income to capital gains income when the fund is terminated. Such conversion is possible primarily by taking depreciation on fund-owned property such as feedyards and equipment.
- <sup>33</sup> These suggested times and costs associated with public securities filing resulted from summarization of the author’s personal correspondence with promoters of funds, including Saxon Funds, Inc., Agri-Link 1973 Fund, Arizona-Colorado Land & Cattle Company, Texland Petroleum, Inc., and Shelter Financial Corporation.
- <sup>34</sup> V. James Rhodes, Rober M. Finley and Glenn Grimes, *A 1974 Survey of Large-Scale Hog Production in the U.S.*, University of Missouri-Columbia Special Report 165, 1974.
- <sup>35</sup> Two Chicago bankers, who are heavily involved in agricultural finance, have argued that as capital replaces labor in agriculture, the control of agriculture shifts from those supplying the labor to those controlling the capital. “Two Bankers Talk About the Restructuring of Agriculture,” *Agri-Finance*, July-August, 1974.
- <sup>36</sup> See, for example, the CAST Report, p. 10; for one estimate of the magnitude of outside capital in cattle feeding during the early 1970’s; see also Joseph C. Meisner and V. James Rhodes, *The Changing Structure of U.S. Cattle Feeding*, University of Missouri-Columbia Special Report 167, November 1974.
- <sup>37</sup> “Cattle Feeders Called ‘Hopeful’ About 1974,” *Feedstuffs*, January 28, 1974, p. 8. Similar cyclical consequences in orchard development were noted in Hoy F. Carmen, “Consequences of Income Tax Law and Regulations: Orchard Development,” in *Income Tax Rules and Agriculture*, Mo. Ag. Exper. Sta. Spec. Rpt. 172, January 1975.

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## APPENDIX A

### UNIFORM LIMITED PARTNERSHIP ACT

#### Sec.

1. Limited Partnership Defined.
2. Formation.
3. Business Which May Be Carried On.
4. Character of Limited Partner's Contribution.
5. A Name Not to Contain Surname of Limited Partner, Exceptions.
6. Liability for False Statements in Certificate.
7. Limited Partner Not Liable to Creditors.
8. Admission of Additional Limited Partners.
9. Rights, Powers and Liabilities of a General Partner.
10. Rights of a Limited Partner.
11. Status of Person Erroneously Believing Himself a Limited Partner.
12. One Person Both General and Limited Partner.
13. Loans and Other Business Transactions with Limited Partner.
14. Relation of Limited Partners Inter Se.
15. Compensation of Limited Partner.
16. Withdrawal or Reduction of Limited Partner's Contribution.
17. Liability of Limited Partner to Partnership.
18. Nature of Limited Partner's Interest in Partnership.
19. Assignment of Limited Partner's Interest.
20. Effect of Retirement, Death or Insanity of a General Partner.
21. Death of a Limited Partner.
22. Rights of Creditors of Limited Partner.
23. Distribution of Assets.
24. When Certificate Shall Be Cancelled or Amended.
25. Requirements for Amendment and for Cancellation of Certificate.
26. Parties to Actions.
27. Name of Act.
28. Rules of Construction.
29. Rules for Cases Not Provided for in This Act.
30. Provisions for Existing Limited Partnerships.
31. Act (Acts) Repealed.

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Section 1. Limited Partnership Defined. A limited partnership is a partnership formed by two or more persons under the provisions of Section 2, having as members one or more limited partners. The limited partners such as shall not be bound by the obligations of the partnership.

Section 2. Formation.

- 1) Two or more persons desiring to form a limited partnership shall
  - a) Sign and swear to a certificate, which shall state
    - i) The name of the partnership,
    - ii) The character of the business,
    - iii) The location of the principal place of business,
    - iv) The name and place of residence of each member; general and limited partners being respectively designated
    - v) The term for which the partnership is to exist,
    - vi) The amount of cash and the description of and the agreed value of the other property contributed by each limited partner,
    - vii) The additional contributions, if any, agreed to be made by each limited partner and the times at which or events on the happening of which they shall be made,
    - viii) The time, if agreed upon, when the contribution of each limited partner is to be returned,
    - ix) The share of the profits or the other compensation by way of income which each limited partner shall receive by reason of his contribution,
    - x) The right, if given, of a limited partner to substitute an assignee as contributor in his place, and the terms and conditions of the substitution,
    - xi) The right, if given, of the partners to admit additional limited partners,
    - xii) The right, if given, of one or more of the limited partner to priority over other limited partners, as to contributions or as to compensation by way of income, and the nature of such priority,
    - xiii) The right, if given, of the remaining general partner or partners to continue the business on the death, retirement or insanity of a general partner, and
    - xiv) The right, if given, of a limited partner to demand and receive property other than cash in return for his contribution.
  - b) File for record the certificate in the office of (here designate the proper office).
- 2) A limited partnership is formed if there has been substantial compliance in good faith with the requirements of paragraph (1).

Section 3. Business Which May Be Carried On. A limited partnership may carry on any business which a partnership without limited partners may carry on, except (here designate the business to be prohibited).

Section 4. Character of Limited Partner's Contribution. The contributions of a limited partner may be cash or other property, but not services.

Section 5. A Name Not To Contain Surname of Limited Partner; Exceptions.

- 1) The surname of a limited partners shall not appear in the partnership name, unless
  - a) It is also the surname of a general partner, or
  - b) Prior to the time when the limited partner became such the business had been carried on under a name in which his surname appeared.

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- 2) A limited partner whose name appears in a partnership contrary to the provisions of paragraph (1) is liable as a general partner to partnership creditors who extend credit to the partnership without actual knowledge that he is not a general partner.

Section 6. Liability for False Statements in Certificate. If the certificate contains a false statement, one who suffers loss by reliance on such statement may hold liable any party to the certificate who knew the statement to be false

- a) At the time he signed the certificate, or
- b) Subsequently, but within a sufficient time before the statement was relied upon to enable him to cancel or amend the certificate, or to file a petition for its cancellation or amendment as provided in Section 25 (3).

Section 7. Limited Partner Not Liable to Creditors. A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, he takes part in the control of the business.

Section 8. Admission of Additional Limited Partners. After the formulation of a limited partnership, additional limited partners may be admitted upon filing an amendment to the original certificate in accordance with the requirements of Section 25.

Section 9. Rights, Powers and Liabilities of a General Partner.

- 1) A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners, except that without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to
  - a) Do any act in contravention of the certificate,
  - b) Do any act which would make it impossible to carry on the ordinary business of the partnership,
  - c) Confess a judgment against the partnership.
  - d) Possess partnership property, or assign their rights in specific partnership property, for other than a partnership purpose,
  - e) Admit a person as a general partner,
  - f) Admit a person as a limited partner, unless the right to do so is given in the certificate,
  - g) Continue the business with partnership property on the death, retirement or insanity of a general partner, unless the right to do so is given in the certificate.

Section 10. Rights of a Limited Partner

- 1) A limited partner shall have the same rights as a general partner to
  - a) Have the partnership books kept at the principal place of business of the partnership, and at all times to inspect and copy any of them,
  - b) Have on demand true and full information of all things affecting the partnership, and a formal account of partnership affairs, whenever circumstances render it just and reasonable, and
  - c) Have dissolution and winding up by decree of court.
- 2) A limited partner shall have the right to receive a share of the profits or other compensation by way of income, and to the return of his contribution as provided in Sections 15 and 16.

Section 11. Status of a Person Erroneously Believing Himself a Limited Partner. A person who has contributed to the capital of a business conducted by a person or

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partnership erroneously believing that he has become a limited partner in a limited partnership, is not, by reason of his exercise of the rights of a limited partner, a general partner with the person or in the partnership carrying on the business, or bound by the obligations of such person of partnership; provided that on ascertaining the mistake he promptly renounces his interest in the profits of the business, or other compensation by way of income.

Section 12. One Person Both General and Limited Partner.

- 1) A person may be a general partner and a limited partner in the same partnership at the same time.
- 2) A person who is a general, and also at the same time a limited partner, shall have all the rights and powers and be subject to all the restrictions of a general partner; except that, in respect to his contribution, he shall have the rights against the other members which he would have had if he were not also a general partner.

Section 13. Loans and Other Business Transactions with Limited Partner.

- 1) A limited partner also may loan money to and transact other business with the partnership, and, unless he is also a general partner, receive on account of resulting claims against the partnership, with general creditors a pro rata share of the assets. No limited partner shall in respect to any such claim
  - a) Receive or hold as collateral security any partnership property, or
  - b) Receive from a general partner or the partnership any payment, conveyance, or release from liability, if at the time the assets of the partnership are not sufficient to discharge partnership liabilities to persons not claiming as general or limited partners,
- 2) The receiving of collateral security, or a payment, conveyance, or release in violation of the provisions of paragraph (1) is a fraud on the creditors of the partnership.

Section 14. Relation of Limited Partners Inter Se. Where there are several limited partners the members may agree that one or more of the limited partners shall have a priority over other limited partners as to the return of their contribution, as to their compensation by way of income, or as to any other matter. If such an agreement is made it shall be stated in the certificate, and in the absence of such a statement all the limited partners shall stand upon equal footing.

Section 15. Compensation of Limited Partner. A limited partner may receive from the partnership the share of the profits or the compensation by way of income stipulated for in the certificate; provided, that after such payment is made, whether from the property of the partnership or that of all the liabilities of the partnership except liabilities to limited partners on account of their contributions and to general partners.

Section 16. Withdrawal or Reduction of Limited Partner's Contribution.

- 1) A limited partner shall not receive from a general partner or out of partnership property any part of his contribution until
  - a) All liabilities of the partnership, except liabilities to general partners and to limited partners on account of their contributions, have been paid of there remains property of the partnership sufficient to pay them,
  - b) The consent of all members is had, unless the return of the contribution may be rightfully demanded under the provisions of paragraph (2), and
  - c) The certificate is cancelled or so amended as to set forth the withdrawal or reduction.

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- 2) Subject to the provisions of paragraph (1) a limited partner may rightfully demand the return of his contribution
    - a) On the dissolution of a partnership, or
    - b) When the date specified in the certificate for its return has arrived, or
    - c) After he has given six months' notice in writing to all other members, if no time is specified in the certificate either for the return of the contribution or for the dissolution of the partnership.
  - 3) In the absence of any statement in the certificate to the contrary or the consent of all members, a limited partner, irrespective of the nature of his contribution, has only the right to demand and receive cash in return for his contribution.
  - 4) A limited partner may have the partnership dissolved and its affairs wound up when
    - a) He rightfully but unsuccessfully demands the return of his contribution, or
    - b) The other liabilities of the partnership have not been paid, or the partnership property is insufficient for their payment as required by paragraph (1a) and the limited partner would otherwise be entitled to the return of his contribution.

Section 17. Liability of Limited Partner to Partnership.

- 1) A limited partner is liable to the partnership
  - a) For the difference between his contribution as actually made, and that stated in the certificate as having been made, and
  - b) For any unpaid contribution which he agreed in the certificate to make in the future at the time and on the conditions stated in the certificate.
- 2) A limited partner holds as trustee for the partnership
  - a) Specific property stated in the certificate as contributed by him, but which was not contributed or which has been wrongfully returned, and
  - b) Money or other property wrongfully paid or conveyed to him on account of his contribution.
- 3) The liabilities of a limited partner as set forth in this section can be waived or compromised only by the consent of all members; but a waiver or compromise shall not affect the right of a creditor of a partnership, who extended credit or whose claim arose after the filing and before a cancellation or amendment of the certificate, to enforce such liabilities.
- 4) When a contributor has rightfully received the return in whole or in part of the capital of his contribution, he is nevertheless liable to the partnership for any sum, not in excess of such return with interest, necessary to discharge its liabilities to all creditors who extended credit or whose claims arose before such a return.

Section 18. Nature of a Limited Partner's Interest in Partnership. A limited partner's interest in the partnership is personal property.

Section 19. Assignment of Limited Partner's Interest.

- 1) A limited partner's interest is assignable.
- 2) A substituted limited partner is a person admitted to all the rights of a limited partner who has died or has assigned his interest in a partnership.
- 3) An assignee, who does not become a substituted limited partner, has no right to acquire any information or account of the partnership transactions or to inspect the partnership books; he 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 his assignor would otherwise be entitled.

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- 4) An assignee shall have the right to become a substituted limited partner if all the members (except the assignor) consent thereto or if the assignor, being thereunto empowered by the certificate, gives the assignee that right,
  - 5) An assignee becomes a substituted limited partner when the certificate is appropriately amended in accordance with Section 25.
  - 6) The substituted limited partner has all the rights and powers, and is subject to all the restrictions and liabilities of his assignor, except those liabilities of which he was ignorant at the time he became a limited partner and which could not be ascertained from the certificate.
  - 7) The substitution of the assignee as a limited partner does not release the assignor from the liability to the partnership under Section 6 and 17.

Section 20. Effect of Retirement, Death, or Insanity of a General Partner. The retirement, death or insanity of a general partner dissolves the partnership, unless the business is continued by the remaining general partners

- a) Under a right to do so stated in the certificate, or
- b) With the consent of all members.

Section 21. Death of a Limited Partner.

- 1) On the death of a limited partner his executor or administrator shall have all the rights of a limited partner for the purpose of settling his estate, and such power as the deceased had to constitute his assignee a substituted limited partner.
- 2) The estate of a deceased limited partner shall be liable for all his liabilities as a limited partner.

Section 22. Rights of Creditors of Limited Partner.

- 1) On due application to a court of competent jurisdiction by any judgment creditor of a limited partner, the court may charge the interest of the indebted limited partner with payment of the unsatisfied amount of the judgment debt; and may appoint a receiver, and make all other orders, directions, and inquiries which the circumstances of the case may require

In those states where a creditor on beginning an action can attach debts due the defendant before he has obtained a judgment against the defendant it is recommended that paragraph (1) of this section be read as follows:

On due application to a court of competent jurisdiction by any creditor of a limited partner, the court may charge the interest of the indebted limited partner with payment of the unsatisfied amount of such claim; and may appoint a receiver, and make all other orders, directions and inquiries which the circumstances may require.

- 2) The interest may be redeemed with the separate property of any general partner, but may not be redeemed with partnership property.
- 3) The remedies conferred by paragraph (1) shall not be deemed exclusive of others which may exist.
- 4) Nothing in this act shall be held to deprive a limited partner of his statutory exemption.

Section 23. Distribution of Assets.

- 1) In settling accounts after dissolution the liabilities of the partnership shall be entitled to payment in the following order
  - a) Those to creditors, in the order of priority as provided by the law, except those to limited partners on account of their contributions, and to general partners,

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- b) Those to limited partners in respect to their share of the profits and other compensation by way of income in their contributions,
  - c) Those to limited partners in respect to the capital of their contributions,
  - d) Those to general partners other than for capital and profits,
  - e) Those to general partners in respect to profits,
  - f) Those to general partners in respect to capital.
- 2) Subject to any statement in the certificate or to subsequent agreement, limited partners share in the partnership assets in respect to their claims for capital, and in respect to their claims for profits or for compensation by way of income on their contributions respectively, in proportion to the respective amounts of such claims.

Section 24. When Certificates Shall Be Cancelled or Amended.

- 1) The certificate shall be cancelled when the partnership is dissolved or all limited partners cease to be such.
- 2) A certificate shall be amended when
  - a) There is a change in the name of the partnership or in the amount or character of the contribution of any limited partner,
  - b) A person is substituted as a limited partner,
  - c) An additional limited partner is admitted,
  - d) A person is admitted as a general partner,
  - e) A general partner retires, dies, or becomes insane, and the business is continued under Section 20.
  - f) There is a change in the character of the business of the partnership,
  - g) There is a false or erroneous statement in the certificate,
  - h) There is a change in the time as stated in the certificate for the dissolution of the partnership or for the return of a contribution,
  - i) A time is fixed for the dissolution of the partnership, or the return of a contribution, no time having been specified in the certificate, or
  - j) The members desire to make a change in any other statement in the certificate in order that it shall accurately represent the agreement between them.

Section 25. Requirements for Amendment and for Cancellation of Certificate.

- 1) The writing to amend a certificate shall
  - a) Conform to the requirements of Section 2(1a) as far as necessary to set forth clearly the change in the certificate which it is desired to make, and
  - b) Be signed and sworn to by all members, and an amendment substituting a limited partner or adding a limited or general partner shall be signed also by the member to be substituted or added, and when a limited partner is to be substituted, the amendment shall also be signed by the assigning limited partner.
- 2) The writing to cancel a certificate shall be signed by all members.
- 3) A person desiring the cancellation or amendment of a certificate, if any person designated in paragraph (1) and (2) as a person who must execute the writing refuses to do so, may petition the (here designate the proper court) to direct a cancellation or amendment thereof.
- 4) If the court finds that the petitioner has the right to have the writing executed by a person who refuses to do so, it shall order the (here designate the responsible official in the office designated in Section 2) in the office where the certificate is recorded to record the cancellation or amendment of the certificate; and where the certificate is to be amended, the court shall also cause to be filed for record in said office a certified copy of its decree settling forth the amendment.

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- 5) A certificate is amended or cancelled when there is filed for record in the office (here designate the office designated in Section 2) where the certificate is recorded
    - a) A writing in accordance with the provisions of paragraph (1), or (2) or
    - b) A certified copy of the order of court in accordance with the provisions of paragraph (4).
  - 6) After the certificate is duly amended in accordance with this section, the amended certificate shall thereafter be for all purposes the certificate provided for by this act.

Section 26. Parties to Actions. A contributor, unless he is a general partner, is not a proper party to proceedings by or against a partnership, except where the object is to enforce a limited partner's right against or liability to the partnership.

Section 27. Name of Act. This act may be cited as The Uniform Limited Partnership Act.

Section 28. Rules of Construction.

- 1) The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this act.
- 2) This act shall be so interpreted and construed as to affect its general purpose to make uniform the law of those states which enact it.
- 3) This act shall not be so construed as to impair the obligations of any contract existing when the act goes into effect, nor to affect any action on proceedings begun or right accrued before this act takes effect.

Section 29. Rules for Cases Not Provided for in this Act. In any case not provided for in this act the rules of law and equity, including the law merchant, shall govern.

Section 30\*. Provisions for Existing Limited Partnerships.

- 1) A limited partnership formed under any statute of this state prior to the adoption of this act, may become a limited partnership under this act by complying with the provisions of Section 2; provided the certificates set forth
  - a) The amount of the original contribution of each limited partner, and the time when the contribution was made, and
  - b) That the property of the partnership exceeds the amount sufficient to discharge its liabilities to persons not claiming as general or limited partners by an amount greater than the *sum of the contributions* of its limited partners.
- 2) A limited partnership formed under any statute of this state prior to the adoption of this act, until or unless it becomes a limited partnership under this act, shall continue to be governed by the provisions of (here insert proper reference to the existing limited partnership act or acts, except that such partnership shall not be renewed unless so provided in the original agreement.

Section 31\*. Act (Acts) Repealed. Except as affecting existing limited partnerships to the extent set forth in Section 30, the act (acts) of (here designate the existing limited partnership act or acts) is (are) hereby repealed.

\*Sections 30, 31 will be omitted in any state which has not a limited partnership act.

APPENDIX B

COLLECTED PROSPECTUSES OF AGRICULTURAL LIMITED PARTNERSHIPS, 1970-mid-1974\*

Name	Prospectus Date	Amount Registered for Sale	Principal Activity
Agri-Link 1973 Fund	8/73	10,000,000	feeding; breeding
Aharado Cattle Feeders	8/73	7,500,000	feeding
American Cattle Feeders	8/73	6,000,000	feeding
American Pork Producers	12/73	2,550,000	purchase sows
Apache Grove Land Program 1972, Ltd.	10/72	5,950,000	oranges, figs, olive trees, pistachios
BC Beef Partners 73			
Cattle Feeding Program	7/73	9,000,000	feeding
Beefeder Cattle Fund 1973	11/73	3,000,000	feeding; breeding
Brinkerhoff Feed Yards, Inc.	11/74	1,500,000	feeding
Chaparral Cattle Feeders	10/72	10,000,000	feeding
Circle Four Land & Cattle Company	8/73	15,000,000	feeding; breeding
Dairy Capital Corp.	7/74	4,895,000	purchase dairy cattle
Dusdman Cattle Breeding Systems/1974	11/73	1,880,000	purebred breeding
Golden West Vineyard	4/73	2,750,000	wine grapes
Gran-Del Farms Ltd.	4/74	3,500,000	breeding cattle; purchase farm
Hi-Plains 1974 Cattle Funds International Breeding Systems/1974	2/74	5,000,000	feeding
Investors Cattle Company	4/74	3,000,000	purebred breeding
K-Bar Cattle Feeding Fund	10/73	6,780,000	feeding
Lava Cattle Funds	12/73	6,000,000	feeding
Mesa 1973 Cattle Feeding Program	1/73	10,000,000	feeding
Mont-Beef Cattle Funds	1973	10,500,000	feeding; breeding
National Farming Program/1973	10/72	10,000,000	feeding; breeding
North American Cattle Co.	6/73	6,000,000	eggs
Petro-Lewis Funds	5/74	10,000,000	feeding; breeding
Prairie States Cattle Co.	8/70	5,000,000	feeding
Prairie States Cattle Co.	12/72	6,000,000	feeding
Prairie States Egg Farms	9/73	3,200,000	eggs
Premier Angus	10/74	10,000,000	feeding; breeding

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ProChemco Cattle Partners Ltd.	10/72	7,500,000	feeding
Steer-West Cattle Feeding Programs-73	11/73	10,000,000	feeding
Stratford 1973 Cattle Program	8/73	10,000,000	feeding
Tejon Agricultural Partners	7/72	16,000,000	grape vineyards, nut, citrus, fig vegetables, general feed crops
TLC Cattle Co., Inc.	11/73	5,000,000	feeding; breeding
Western Beef Cattle Fund, Inc.	6/73	7,500,000	feeding
Western Heritage Cattle Funds	9/73	6,000,000	feeding
Western Trio Cattle Company	5/73	12,000,000	feeding
Wheatheart Cattle Company	7/73	10,000,000	feeding
Yucca Land and Cattle Corporation Fund	12/72	9,494,000	feeding; breeding

\*The list is indicative yet not exhaustive of agricultural offerings of limited partnership interests. Appreciation is expressed to William H. Scofield, National Economic Analysis Division, ERS, U.S.D.A. for his assistance in compiling this list.