NCAT Beginning Farmer Business Tip Sheet Series

Tips about: **Farm Business Structures**

Choosing the legal structure for your farm is an important decision for beginning farmers. The farm business structure will affect the legal and tax liability of your farm. This is a short introduction to the major business structures, including the pros and cons of each. Professional legal assistance is strongly recommended to establish your business as anything other than a sole proprietorship, and may be helpful even in that context to determine if a sole proprietorship is the best structure for your farm business.



Photo: Dennis Chamberlin

Sole Proprietorship

If you make no effort to legally establish your business, the default business structure you have "chosen" is the sole proprietorship. In this structure, there is no legal distinction between you and your farm business.

Many farms are sole proprietorships, and this might be perfectly appropriate while your farm is small and in the beginning phase. If you are a sole proprietor, you do not have to file legal forms declaring your status; however, you should file a Schedule F with your personal federal income tax return to report farming income and expenses. Schedule F is required by some agricultural grant and loan programs as part of demonstrating a farming track record.

Advantages: The biggest advantage of the sole proprietorship is that it requires no special legal declarations or procedures. So if you do nothing in this regard, you are considered a sole proprietor.

Considerations: Because there is no legal distinction between the owner and the business, the owner is liable for everything that the business does. In other words, in the unfortunate event of litigation against your farm, all of your personal property and assets could be vulnerable.

Cooperative

A cooperative is controlled and operated by a group of "members." Each member contributes equity (ownership) capital and shares in the control of the firm on the basis of one-member, one-vote principle (not in proportion to the member's contribution).

Advantages: Cooperatives are based on three core principles that focus on the owners as users: user benefit, user control, and user ownership.

Considerations: Every member, regardless of their level of investment, gets one vote. Management of the cooperative can be unwieldy. As cooperatives grow, they often vote to hire professional managers to address this problem.

Partnership

A partnership is an arrangement where more than one businesses and/or individuals agree to advance their business interests together. Most commonly, partnerships form among individuals who share in the work and in the profits and losses.

Partnerships can be assumed and informal (as with spouses), but if such partnerships dissolve due to death, divorce, or other life situations, untangling the business from personal considerations can be devastating to a beginning farm operation. A lawyer could offer advice on how to minimize such possibilities. A formal, legal partnership is advisable in any case.

Advantages: You are only taxed once. The IRS views partnerships as "pass through" entities because the profits and losses "pass through" the business to the partners. The partners pay taxes on their share of the profits (or deduct their share of the losses) on their individual income tax returns. Each partner's share of profits and losses is usually outlined in the partnership agreement.

Considerations: Depending on the partnership structure and the jurisdiction in which it operates, owners in a partnership may be exposed to greater personal liability than they would as shareholders of a corporation.

Are the partners in agreement about the goals of the farm? This is an important question to ask before forming a partnership.

B-Corp (Benefit Corporation)

B-Corporation charters require the company to conform to socially beneficial practices. These practices can include protecting the environment or preserving employee benefits. Often suited to nonprofits, this is a type of business entity that someone might consider, particularly if they want to do educational programs.





Limited Liability Company

The Limited Liability Company (LLC) offers limited personal liability with the single taxation feature of partnerships and sole proprietorships. An LLC's profits and tax benefits are split any way the stockholders (owners that are businesses) and shareholders (owners that are individuals) choose. In most states, the LLC can have one owner or many.

Advantages: The LLC structure offers liability protection and financial flexibility.

An LLC files a tax return only for the purpose of information. Each shareholder files separately.

LLC owners have less administrative requirements and recordkeeping than a corporation. For instance, they are not required to have a board of directors or officers.

LLCs have more financial flexibility than a sole proprietorship, such as the ability to raise needed capital through shareholder investments in the business.

Considerations: Though they aren't required to have a board or officers, the members of an LLC must produce, and have on record, governance and protective provisions regarding their operation.

State taxation of LLCs varies. Many states, including Alabama, California, Kentucky, New York, Pennsylvania, Tennessee, and Texas, levy a franchise tax or capital values tax on LLCs.

Annual renewal fees for LLCs are required and can be higher than those for other structures.

C-Corp

The C-Corp is a corporate business structure that protects you and other owners from personal liability and provides some other non-tax benefits, such as the ability to raise capital from private investors. In fact, the C-Corp is often used as a first step before transitioning to the "public corporation" form, in which a company goes from offering shares privately to trading them publicly on the open market.

Advantages: The primary advantages are limited personal liability and more options for shareholder investments.

Considerations: C-Corp income is taxed twice: first as corporate income, then as shareholder (dividend) income.

S-Corp

S-Corp income is passed through its stockholders in proportion to their investment and is taxed at personal income tax rates. S corporations ("S" stands for "small") can have only one type of stock and only a limited number of stockholders.

Advantages: It's easier to raise capital as a corporation than as a sole proprietorship or partnership. The S-Corp form provides stockholders/shareholders with the corporate protection of limited personal liability but does not come with additional taxation of corporate profits.

Considerations: An S-Corp must follow numerous regulations and requirements, is subject to close scrutiny by the Internal Revenue Service, and may have high costs to set up and maintain the corporate structure.

Resources about Farm Business Structures

- Agricultural Marketing Resource Center www.agmrc.org/business_development/starting_a_business/creating_a_business/legal-organizational-structure
- Information about B-Corp: www.bcorporation.net/what-are-b-corps
- Information about cooperatives on the ATTRA website: https://attra.ncat.org/marketing.html#cooperatives
- IRS Website for Employer Identification Number www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Employer-ID-Numbers-(EINs)-
- New England Small Farm Institute www.smallfarm.org/main/for_new_farmers/resources_by_topic/business_planning
- Small Business Information, Business Structure Essentials http://sbinformation.about.com/od/ownership1/a/llcincorporated.htm

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