Farm Management

How to choose a farm business structure

FARMERS and landowners considering how to organize their operation and assets into a business entity have several options. Understanding the differences between different business entities is critical to making a good decision.

Country Counsel

By ROBERT MOORE

Partnerships

The most common business entity for farming operations is a partnership. The popularity of partnerships is likely due to the ease of startup and informal structure. Partnerships can be formed without any written documents, although that is not advisable. Generally, a business venture where two or more people share profits can be a partnership. Most partnerships are started when family members begin farming together and sharing profits. It is not uncommon for farmers to be in a partnership and not realize it.

Partnerships have several advantages. The tax structure is "flow through," meaning the partnership does not pay taxes. All profits and losses flow through to the partners. This structure avoids taxation at both the entity and individual levels. Also, assets can generally be distributed out of the partnership to the partners without triggering taxes.

The biggest disadvantage with partnerships is liability exposure. A partner is fully liable for all activities of the partnership, including other partners and employees. This liability exposure can be overcome to some degree with liability insurance.

Large grain operations often choose to organize as partnerships to maximize Farm Service Agency benefits. Partnerships are the only business entities that can receive multiple FSA payments. With farm program payments likely to decrease significantly with the next farm bill, partnerships may not be as important in this role in the future.

Corporations

A corporation is comprised of shareholders who own the company. To organize a corporation, Articles of Incorporation must be filed with the Ohio secretary of state. The primary advantage of a corporation is liability protection. A shareholder is not personally liable for the actions of a corporation, other shareholders or employees.

The tax structure of a corporation can be both advantageous and detrimental, depending on the situation and objectives of shareholders. Corporations can be either C-corporations or S-corporations.

C-corporations are taxed at both the corporation level and shareholder level (double taxation). However, the first $100,000 of profits in a C-corporation is taxed at relatively low rates, allowing for low-rate capital buildup. C-corporations also allow for the most fringe benefits, like health insurance and retirement plans.

S-corporations are similar to partnerships in that the profits and losses flow through to the shareholders. The strategy with S-corporations is to treat a portion of profits as a salary to the shareholder and a portion as a distribution. The distribution is not subject to self-employment taxes, often saving significant taxes.

A primary disadvantage of corporations is transferring assets out. Generally, any asset leaving a corporation at a gain will be considered a taxable event. For example, a $100,000 tractor distributed to the shareholders with a $0 tax basis (fully depreciated) will be treated as if the tractor were sold for a $100,000 profit.

Over the life of a corporation, significant tax savings can be enjoyed. Upon termination of the corporation or transferring assets out of the corporation, the disadvantages are quickly realized.

LLCs

The limited liability company has become the choice of entity for most new businesses. LLCs provide the liability protection of a corporation but can be taxed as a partnership, C-corporation or S-corporation. LLCs have almost made partnerships obsolete. They are more flexible and typically easier to set up than corporations. And, if taxed as partnerships, they do not trigger tax upon dissolution or transfer of assets out of the company.

The decision of whether to tax the LLC as a partnership, C-corporation or S-corporation should be made with the help of a tax adviser.

Moore is an attorney with Wright Law Co. LPA
614-791-9112
rmoore@wright-law.net