# Farm Organizational Structure Primer

***This resource provides information on the different business organizational structures available to our members. It is to be used as guide to allow us to better answer questions from members on how to choose and create a formal business entity and direct them to the proper state agencies for more information on state rules and filing details.***

***Our mission does not include drafting business entity documents or setting up legal entities.***

**General provisions:**

- Entity types differ in regard to their level of complexity, how liability is assessed, number of owners, ability to raise capital, tax status, and handling of survivorship.
- Formal entities are considered persons that can stand in for and protect its organizers from personal liability as long as certain standards are upheld
- Member businesses may operate without forming an entity and will be treated as a sole proprietorship by default
- The pros and cons to consider in choosing to form a business entity:
    - Pros:
        - Separating personal assets from business assets (e.g. a farm creditor can pursue business assets alone, not personal bank accounts etc.)
        - Raising money from banks/investors can be easier through a stable legal entity
        - Succession planning made easier and more organized, and can result in more favorable tax treatment, and allow for transfer of the business as a whole and not just individual assets
        - Securing the business name
    - Cons:
        - Increased business management activity
            - maintaining separate bank accounts & accounting systems
            - ensuring the business is properly capitalized

**Entity Types:**

Sole Proprietorship:

- Easy to form and offers owner complete control of the business;
- If no steps taken to form or define a business, sole proprietorship by default;

- Business v. personal assets/liabilities not separated so operator can be held personally liable for business debts/obligations;
- Trade names can be obtained;
- Harder to raise money from banks and other investors

Partnership:
Good for businesses with multiple owners who are not yet ready for a more formal structure.
- Limited Partnership (LP):
    - One partner has unlimited liability (more control), the others have limited liability (less control)
    - Partners are responsible for the conduct of all partners
    - Profits pass through personal tax returns
    - Controlling partner pays self-employment taxes
    - *Examples:* movie production where the investors are limited partners, real estate property managers and their outside investors
- Limited Liability Partnership (LLP):
    - Similar to LP but each owner has limited liability
    - Each partner not responsible for the actions of the others
    - *Examples:* law firms, medical practices, accounting offices

Limited Liability Company:
- In most instances, personal assets (cars, home, bank accounts) protected from business liabilities
- Even though statutes often don't require organizing documents, protection from liability can be weakened without these
- Profits/losses can generally pass through personal income without being confronted with corporate taxes
- Members are "self-employed" and must make self-employment, Medicare, SS tax contributions
- They have a limited life in many states and may be dissolved when members are added or removed
- Good for businesses with moderate or high risk, those who have substantial personal assets to protect, those seeking lower tax rates than assessed to corporations
- *Examples:* Sony, Nike, Exxon Mobil

Corporations:
- C Corp:
    - These entities are separate from their owners, offer the strongest protection from personal liability, and can raise $ by selling stock
    - Costlier to form; require more record-keeping, operational processes and reporting

    - Pay income tax on profits (and individual shareholders also pay taxes when they are paid dividends)
    - Good for moderate or high risk businesses that need to raise money, and may seek to go public or be sold
    - *Examples:* Wal-Mart, IBM, Apple
- Benefit Corp ("Benefit Corporation"):
    - For-profit entity recognized by most states
    - Taxed the same as C Corps
    - Goals include producing a public benefit as well as profits (and report demonstrating public contribution may be required)
    - Examples: Natura, Laureate, Ben & Jerry's is a B Corp subsidiary of Unilever
- S Corp:
    - These avoid double taxation C Corps face
    - Not all states recognize them and IRS filing is required (rather than state registration)
    - Farmers who make more than the average can classify excess income a dividends and receive a lower tax rate
    - Limits on # of owners who must be U.S. citizens
- Close Corporation:
    - Look like a B Corp but less formal, apply to smaller companies, can be run by a small # of shareholders without a board of directors
    - *Examples:* Albertsons grocery stores, Cargill
- Nonprofit Corporation organized as 501 (c)(3) or 501(c)(4) or other
    - They do charity, education, religious, literary or scientific work
    - Most farms are unable to meet the above eligibility requirements
    - Can receive tax-exempt status on profits made, must apply to IRS for this status
    - Organizational rules are similar to C Corp and profit handling rules must be followed (e.g. can't distribute to a political campaign)
    - *Examples:* FTCLDF (501(c)(4), Better Business Bureau, Girl Scouts of America

<u>Cooperative:</u>

Entity owned and operated for the benefit of those that use its services.

- Profits and earning are distributed among user-members
- There is usually a board of directors and members having voting power to control the mission
- *Examples:* credit unions, grocery co-ops

Formation Steps:

- Consult an accountant/tax professional on tax implications in selecting correct entity;
- Confirm that business plan does not violate anti-corporate farming statutes present in some midwestern states[1];
- Form the entity:
    - Prepare a formation document (the kinds of organization documents that are necessary vary from state to state. Many will require by laws, or other organization documents that establish procedures for operating the business).
    - File with the proper state agency (usually Secretary of State), pay any associated fees
- Create an organizing document if needed (does not need to be filed with the state as it is a private contract among the owners on how to operate/manage the business

State Provisions Generally:

- Businesses can create their own rules of operation as long as they don't run afoul of the state's laws.

Other Business Formation Considerations:

- Assess name availability and registration
- Comply with business licensing requirements – many food businesses require additional licensing and permits with the proper state agencies
- State and federal tax registration
- Zoning and local requirements will have to be reviewed to ensure compliance
- Obtain necessary business insurance
- Investigate funding options as needed
- Additional state and federal government requirements will need to be met if the business has employees, e.g. payroll tax, new hire reporting, etc.

References:

https://www.sba.gov/business-guide/launch-your-business/choose-business-structure#section-header-1

https://www.irs.gov/businesses/small-businesses-self-employed/business-structures

[1] Iowa, Kansas, Minnesota, Missouri, North Dakota, Oklahoma, South Dakota and Wisconsin all have anti-corporate farming laws that prevent LLCs and corporations from owning or leasing farmland. This may not affect most farm businesses directly where an individual, not an entity, maintains title to the farmland itself. In addition, exceptions in many of these laws allows entities with a few related shareholders or members to own or lease the land. At times, an individual can lease farmland to a farm business.