

Selecting the Right Business Entity for Your Farm or Ranch

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RuralTax.org



This information changes...often.

This is educational information, not tax or legal advice. Information is based on material from LGUTEF, Ruraltax.org, and IRS. Please be a good consumer of professional services.



Why choose a business structure?

Factors to Consider in Selecting Your Farm's Business Entity

FACTORS TO CONSIDER

- Liability
- Taxes
- Ownership and Management
- Authority and Formalities
- Capitalization
- Transfer and Estate Planning
- Government Programs



FACTORS TO CONSIDER - LIABILITY

- Protection of personal liability
- Liability may be financial or injury
- Not a replacement for insurance



FACTORS TO CONSIDER - TAXES

- Entity level taxation
- Pass-through taxation
- Tax law changes



FACTORS TO CONSIDER - OWNERSHIP

- Flexibility vs rigidity
- For example
 - ⑩ Limited partner vs general partner
 - ⑩ Non-voting shareholder vs voting shareholder



FACTORS TO CONSIDER - AUTHORITY

- Individual authority
- Ownership authority
- Business formalities



FACTORS TO CONSIDER - CAPITALIZATION

- Adding assets to the business
- Not adding assets to the business
- Taking out debt to capitalize



FACTORS TO CONSIDER – TRANSFER AND ESTATE PLANNING

- Facilitate transfer as shares or units instead of individual assets
- Some provide protection for retiring generation, e.g. limited partnerships
- Gifting or sales may be discounted in some cases



FACTORS TO CONSIDER – GOVERNMENT PROGRAMS

- Typically, payments limited by legal entity
- Active engagement matters
- Recent exceptions allowed for higher per entity limits, e.g. CFAP



FACTORS TO CONSIDER

- Liability
- Taxes
- Ownership and Management
- Authority and Formalities
- Capitalization
- Transfer and Estate Planning
- Government Programs
- Reporting Requirements/Additional Bookkeeping



Reporting Requirements/Additional Bookkeeping

- Filing a balance sheet with the entity tax return is required under the following circumstances.

Summary of Thresholds

| Form | Receipts Threshold | Assets Threshold | Balance Sheet Required? |
|-------------|--------------------|------------------|--|
| Form 1065 | \$250,000 | \$1 million | If total receipts or total assets exceed thresholds, or small partnership exception doesn't apply. |
| Form 1120 | \$250,000 | \$250,000 | If total receipts or total assets exceed thresholds. |
| Form 1120-S | \$250,000 | \$250,000 | If total receipts or total assets exceed thresholds. |



Your factors to consider may be different than other farmers' factors. There is no one right business structure.



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Basics of Business Entities

What are the Business Structures?

- Sole Proprietorship
- Qualified Joint Venture
- General Partnership
- Limited Liability Company
- Limited Liability Partnership
- Limited Partnership
- Family Limited Partnership
- C Corporation
- S Corporation



Sole Proprietorship


- Easy to set up
- Not separate from the owner
- Business assets and liabilities are owned by operator
- No corporate formalities
- Held personally responsible for business liabilities



Sole Proprietor

Schedule F
Or
Schedule C
on 1040


- Sole Proprietor reports business income on his/her personal tax return

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Qualified Joint Venture

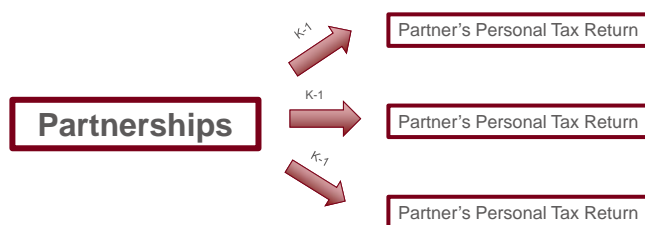
- Unincorporated business owned solely by a married couple
- Acts like an informal 50:50 partnership between spouses
- Both spouses must materially participate
- Business (or assets) are not held in the name of a state law entity (partnership, LLC, etc.)
- Each spouse files Schedule F or C, Schedule SE, etc.
- Both spouses pay self-employment (SE) tax on earnings

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Partnership (General Partnership)

- Similar to sole proprietorship, but multiple people
- Easy set up
- Managing workload shared with partners
- More assets with more people
- Partners personal assets are available to satisfy business liabilities.
- Potential for personal conflicts between partners

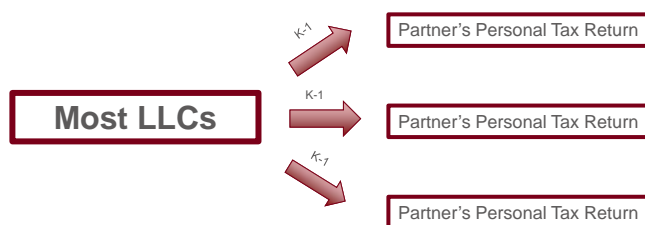


- Partner's share of profits (loss) passes from a partnership to the individuals' return(s)
- No income tax is paid at the partnership level
- All business income subject to self employment tax



Limited Liability Company (LLC)

- Separate legal entity, may have as few as one member
- Owner(s) decides how to be treated for taxes
- Most often treated as a pass-through partnership for taxation
- Personal Assets are not available to satisfy business liabilities



- Earnings from LLC subject to Self-Employment Tax



Limited Liability Partnership

- Two or more persons involved
- Each partner's personal assets are not exposed to satisfy business liabilities
- Each partner remains liable for his/her liabilities and the liabilities arising from the wrongful acts or omission of those to whom the partner had supervisory duties.
- Functions similar to a general partnership but with a formalized legal structure (corporate veil)
- Pass through taxation



Limited Partnership

- Two or more persons involved
- Don't confuse it with limited liability partnership
- General partner oversees the business
- Limited partners do not partake in the management of the business
- The General Partner's personal assets are exposed to business liabilities, whereas the Limited Partner's personal assets are not exposed to business liabilities beyond their own investment.
- LP, LLLP
- Pass through taxation



Family Limited Partnership

- A family limited partnership (FLP) is a business or holding company owned by two or more family members in which each family member can buy shares in the venture for a potential profit.
- There are two types of partners in an FLP: general partners and limited partners.
- FLPs are commonly set up to preserve generational wealth within a family, allowing for tax-free transfers of assets, real estate, and other wealth.



C Corporation

- Pay income taxes on profits earned by the business
- Income generated by business is distributed to shareholders as dividends or salary paid to owners
- This is taxed at the individual owner level
- Plus, excess retained earnings may be subject to accumulated earnings tax
- Double taxation
- Owners' personal assets are protected from business liabilities.
- Potential for more tax deductions and lower SE tax



C Corporation

**C Corporation
pays it's own
tax and pays
wages, rent,
and
distributes
dividends**



Shareholders



Shareholders



Shareholders



S Corporation

- File a business tax return and each owner a K-1
- Profit or loss are “passed-through” to the owners and taxed at individual tax rates
- Pass-through profits not subject to SE tax
- Required to pay salary to shareholders
- More formal rules and procedures than partnership
- All corporations provide owners with personal asset protection from business liabilities.



- Earnings from LLC subject to Self-Employment Tax
- S Corp must pay shareholders a salary.
 - IRS does have some resources for determining appropriate salary
 - IRS Reasonable Compensation Job Aid for IRS Valuation Professionals (October 29, 2014)

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Land Ownership with Entity

- Generally, not a good idea with C Corp
 - Double Taxation
 - Built in gains tax
- Common situation is to own land in an LLC separate from the operating entity

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Business Entity Ownership vs Other Types of Ownership

- Business entities may be used in combination with one or more other types of ownership
- Succession plans could involve multiple strategies
- For example, farmland may be held outside the entity
 - Sole ownership, tenancy in common, joint tenancy, or via trust(s)
- This program does not explore the multitude of other ownership options



Tax comparison of various entities

| Characteristics / Entities | Tax Treatment |
|---------------------------------|---|
| C Corporations | Corporation taxed on its earnings at the corporate level and the shareholders have a further tax on any dividends distributed (double taxation) |
| S Corporations | Entity generally not taxed as the profits and losses are passed through to the shareholders (pass through taxation) |
| Sole Proprietorship | Entity not taxed, as the profits and losses are passed through to the sole proprietor |
| General Partnership | Entity not taxed as the profits and losses are passed through to the general partners |
| Limited Partnership (LP) | Entity not taxed as the profits and losses are passed through to the general and limited partners |
| Limited Liability Company (LLC) | Entity not taxed (unless chosen to be taxed) as the profits and losses are passed through to the members |

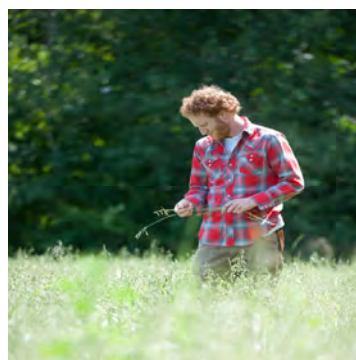


Introduce Case Study



Case Study Farm Families

Brother and Sister with separate farms but also farm together.



•Photo credit:
• Scott Streble



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•CT Ryan Photography

Each family has own operation but share some equipment like combine as an informal partnership. Brother farms 1100 acres with \$166,000 net farm income.



Sister has son starting to farm with her, but only has hog barn as own operation, son has off farm job. Sister farms 1000 acres with \$150,000 net farm income. Son has \$16,000 net farm income.



Case Study Discussion #1

- Farm's Goals
 - Saving taxes
 - Personal Liability
 - The family does not mind dealing with extra record keeping or structure
 - The family is interested in setting something up to ease transfer of the farm to the next generation.



Case Study Discussion #2

- Farm's Goals
 - Liability Protection
 - The ability to pool assets
 - The family wants to do something simple (record keeping and formalities are a challenge).





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