


# Business Structures and Strategies

While planning the transfer you may consider changing your business model. This may sound like a radical step just to get the farm transferred, but there are other motives for changing one's business plan besides making sure the farm is successfully moved onto the next farming generation such as a comfortable retirement, a fair inheritance for the children, and so on. Depending on the business arrangement you choose, the many government regulations that impact retirement, inheritance, property transfer and your business can alter the playing field to open up new opportunities. This is one of the reasons why it is so important to plan ahead and determine your family's goals for retirement, inheritance, the business, etc.

The farm transfer is almost like a game with very creative rules. In all games there is an objective, get to the finish line, score a run, make a touchdown, get a monopoly, make a royal flush. Most games have one or two goals. For a fully successful transfer you of course, as was discussed in "Planning Ahead," will have many. The legal system acts as the referee or game designer. Your task is to find the best route to your goals without being penalized or obstructed. There are simple maneuvers that can help you achieve them such as leases and installment sales, but when something doesn't work or if it could work better, a different business arrangement can act as the wild card to give you the edge. There can be serious consequences for using one of these wild cards, however. So it is recommended that you find the one that fits you best and stick with it. A number of business models will be examined here. We shall look at corporations; limited liability companies; the traditional, single owner farm; as well as some additional business options that could have a significant impact on the farm transfer.

## The Corporation

When one thinks of a corporation, thoughts of Sears, Kraft, ExxonMobil, General Electric and Ford come to mind, the kind of companies that make up some of the biggest money movers in the nation. Your farm does not need to be a fortune 500 company to incorporate, however. A corporation is simply a business that has become an individual in the eyes of the legal system. It requires its own name and bank account. It pays its own taxes, hires its own employees, can lease or rent, buy or sell, and do everything that one would be able to do as a private business owner. Corporations are unique in that they are not owned by an individual. They are owned by shareholders. The shareholders are responsible for electing a board of directors which acts like the brain of the corporation, making decisions through majority vote. Two types of shareholders exist. There are majority shareholders. They control the most stock and, because each stock grants the owner a single vote towards the election of the board of directors, they have the most say in the business.

The other type of shareholders are minority shareholders. They do not have much of a say in the management of the business. Giving up personal ownership of a company in exchange for shares, board meetings, votes and corporate bureaucracy may not sound the most advantageous solution to one's transfer goals, but it does open up many unique benefits that are not available to the private owner.

## Limited Liability Company

LLC is one of the more common acronyms in business, but what does it mean? A Limited Liability Company (LLC) combines the aspects of a corporation and a partnership. This combination makes it an attractive form of business to many An LLC combines the tax flexibility of a partnership while personal asset protection of a corporation. You can protect yourself in the event that a judgment is levied against the company. In a properly formed LLC, owners can report their share of profit and loss on their individual tax returns without filing a separate corporate tax return (called pass-through taxation) and, as the name suggests, the owner has limited liability for business debts and obligations. This also protects LLC's from the double taxation that corporations face because the IRS will tax both the corporate income and the shareholder dividends.

Structuring your business as an LLC has many advantages, especially for small to medium business owners. In addition to the financial flexibility and security that it offers, there is no limit to how many owners an LLC can have and those owners do not have to be United States citizens or permanent residents. An LLC can be formed anywhere but generally it is best to base it in the state where you primarily operate. This is generally less expensive then forming in a different state and registering to do business in your home state.

So how does an LLC stack up against other types of business organizations? As previously mentioned it has the tax advantages of a sole proprietorship but with the liability protection of a corporation and are also often eligible for tax deductions that otherwise only apply to corporations. An LLC also avoids the double taxation of a corporation and also is not required to hold yearly meetings and record official meetings like general corporations. Perhaps one of the most significant differences is that, unlike corporations, profits do not have to be distributed according to the percentage of ownership. Finally LLC's do not have stock, which can be a bonus because issuing stock can be a hassle to the company but could also be a problem because stock cannot be offered as an incentive for investors.

**Limited Liability Partnership**

The Limited Liability Partnership (LLP) shares several characteristics with an LLC. Contrary to other forms of partnerships, where the general partners assume full financial liability for the company and any financial debt, a properly registered LLP provides the partners with some protection from business debts. The liability is less than what is provided by and LLC and there are also some states that impose insurance requirements, or an escrow account on the owners. Some states only grant LLP's to certified professionals which requires a license in order to do business. Limited Liability Partnerships, like general partnerships, can have management input from any of the partners.

The LLP is particularly attractive to businesses that were unable to incorporate or form an LLC, such as lawyers or accountants. Taking the existing general partnerships and turning them into corporations or LLCs can be rather expensive. LLPs also allow for the same pass-through taxation as LLCs.

**Limited Partnership**

Limited partnerships (LP) seem to be a dying breed. Once a popular form of doing business; the LP has been far surpassed by the Limited Liability Company. LPs can be formed for basically any commercial organization, but they are mostly used for special, limited engagements such as movies or estate planning. Limited Partnerships are structured with one or more general partners and one or more limited partners. The general partners manage the company and have unlimited personal liability for business decisions made against the company. Until 2001 the limited liability option was only available to the limited partners if they did not take an active role in the management of the company.

This organizational structuring is what has made the Limited Partnership lose its appeal. The LLC allows personal asset protection for all members of the organization as well as qualifying for the pass-through taxation that is described above. Furthermore the freedom to structure the management of an LLC according to an operating engagement is appealing to many small business owners. The reason the LP is popular with short-term engagements, and may not be the ideal option for a farm, is because one strong financial backer will prefer to provide the money and have the other partners do the actual work.

## Sole Proprietorship

The sole proprietorship (or just proprietorship) is a business entity where there is no legal separation between the owner and the individual. The individual operates the business in his or her own name, although many owners will chose a trade name so that they can perform business under a separate name and open a business account for their operations. A main reason that many owners opt for a sole proprietorship is that there is no additional set up in order to form or dissolve the business. The profits in this type of business organization belong solely to the owner and so the business is not subject to the double taxation that a corporation is and the income is reported only on the personal income tax report of the owner. The drawback of the simplicity of the sole ownership is that there is no protection of the owner's personal assets in the event that the business profits suffer. As a business becomes more successful the number of risks increase, so the sole proprietorship can be turned into a Limited Liability Company. The LLC would still be viewed the same, as far as income tax goes, because both claim their profits on personal income tax reports.

Sole proprietorships offer many advantages for a single owner who is looking to start a business. It is a simple and cost effective way to begin operating but can also create certain difficulties. For example, it may be harder to raise money on a sole proprietorship because there are no shares of stock to be sold to investors and also there can be a legitimacy issue when comparing a small single-owner business to a major Corporation or LLC. Another concern can be healthcare. The owner does have the ability to provide healthcare for the business but finding a good health plan to cover his or her family can be much more difficult, especially if a family member had a previous medical problem.

## Cooperative

A co-operative, or Co-op, is an organization that is voluntarily structured for the purpose of meeting a common goal. This is a jointly-owned and democratically controlled entity that is controlled by the people who use their services. Co-ops exist around the world and in almost every corner of the business market including housing, building, retail and even banking, in the form of credit unions. The main, distinguishing characteristic of a co-op is that the members have a close relationship with the organization as producers, consumers or employees. They operate with a "one member, one vote" system which is also a major difference from a traditional capital stock corporation.

Agricultural co-ops are typically farmers in a given area who pool their resources and they are often structured as non-profit 501(c) 3 or 501(c) 6. These co-ops are very common in rural areas and they traditionally come in 2 forms. The supply cooperative provides farmers with front-end farming necessities such as seeds, fertilizers and other services. There are also agricultural marketing cooperatives, also known as farmer's co-ops. These organizations are owned by farmers for the purpose of packaging, distributing and marketing produce.