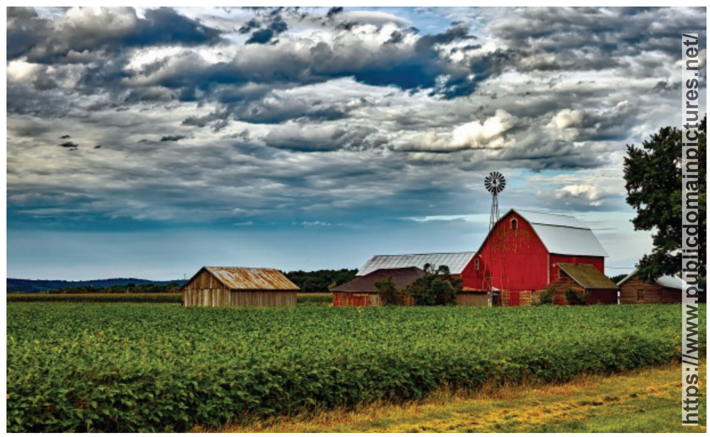
Volume 11, Issue 9 September 2023

RightRisk™

RightRisk News

Organizational Frameworks for Businesses in Today's Agriculture

Historically, farms and ranches were operated as sole proprietorships. The land, machinery, livestock, and other assets were owned and used by an individual or couple. Likewise, the individual (or husband and wife) farmer/rancher was personally responsible for all debts and financial obligations owed by the business. The farmer or rancher was the business, and the business was the farmer or rancher.



In today's world, there are a number of organizational structures that may better meet the needs of farm/ranch businesses. Each organizational structure has its strengths and weaknesses. Before a decision is made about the legal entity under which to operate, a person – or a person and his or her family and other partners – must determine the goals and needs of the business and its assets.

RightRisk published a series of fact sheets describing the basics of seven alternative organizational structures for farm and ranch businesses. Each fact sheet outlines seven aspects of a specific organizational structure: general characteristics, how the entity is formed, operational attributes, liability of the owners, income tax attributes, transfer of ownership, and dissolution. Additionally, a chart comparing the seven types of organizations summarizes key aspects of each. All eight documents are available on-line, free of charge, at **RightRisk.org/RiskConcepts**.

Sole Proprietorship

A sole proprietorship is not a legal entity. It simply refers to the person who owns the business. No formal filing is required; the act of buying or selling goods and services may establish a sole proprietorship.

Sole proprietors typically conduct business in their own names. They may, and often do, commingle personal and business property and funds. Sole proprietors are personally liable for all business-related debts, legal issues brought against the business, and taxes.

Ownership transfer occurs when the sole proprietor sells the business-related assets, gifts the assets to another person or dies. A sole proprietorship ends when one of these events occurs.

How Much Risk is Right for You?

C Corporation
A "C Corporation" (also known as a corporation or regular corporation) is created when Articles of Incorporation are filed with appropriate state officials. The Articles of Incorporation include a board of directors, elected by the shareholders, and issuance of ownership shares.

Management authority of a C corporation is usually exercised by or under the authority of a board of directors. Although the laws may vary by state, a business meeting must be held at least annually.

Net income is reported at the entity level to the Internal Revenue Service (IRS) and is subject to taxation. Any earnings distributed to the shareholders are subject to personal income tax. Liability is typically limited to the agreed-upon value of each shareholder's contribution or portion of ownership.

Shareholders may sell or otherwise convey shares at any time to any other legal person. The new owners become a shareholder with all the rights that such a position entails. The process of terminating a corporation is spelled out in the corporate statues. Most such rules are mandatory and cannot be circumvented by agreement of the parties.

S Corporation
A subchapter S Corporation (sometimes known as a "sub S" or "S Corp") is an ordinary corporation taxed under subchapter S of the Internal Revenue Code. It is created when articles of incorporation are filed with the appropriated state officials.

Two major differences between a C Corporation and an S Corporation are that a Sub S Corporation is: (1) limited to 75 shareholders and (2) not taxed at the entity level. A Sub S Corporation is known as a "pass through" entity; net profits are distributed to the shareholders according to the number of shares held by each owner. Earnings are then taxed as personal income.

Partnerships
A general partnership is simply an association of two or more people who agree to carry on a business as co-owners for profit. The partnership form of enterprise ownership is very flexible and state partnership statues provide default rules pertaining to management rights and the calculation of each partner's share of profits and losses. However, partners in a partnership agreement are generally free to change these default provisions by agreement.

There is no requirement to file an agreement for a General Partnership, but owners will find it best if a written agreement is drafted that describes management rights, how profits and losses will be shared, and outlines the duties of loyalty and care. General partners share personal liability for all debts of the partnership.

A Limited Partnership is formed by filing a certificate of limited partnership with appropriate state officials. There are two classes of partners in a limited partnership – general partners and limited partners. Management is vested in the general partners. Furthermore, limited partners commonly have personal liability only up to their share of the ownership.

A Limited Liability Partnership (LLP) is created by a general partnership filing an application with the appropriate state officials and it must be renewed, often annually. All general partners have limited liability relative to the other partner's debts and liabilities. Unless specified in a written agreement, general partners share equally in the profits and losses of the business.

There is no entity-level taxation of profits for partnerships. As pass-through entities, net profits and tax liabilities flow to the individual partners in accordance with each partner's share in the partnership. Partners are generally not entitled to transfer ownership to another person without the unanimous consent of all other partners. Dissolution of a general partnership begins when a partner withdraws due to retirement, announces an intent to withdraw, dies, become incapacitated, or is removed by the other partners.

Limited Liability Company

The Limited Liability Company (LLC) is a creature of statute, recognized in each jurisdiction only by virtue of a legislative enactment in each state. An LLC is created when organizational documents are filed with appropriate state officials. Under the default rules of every state, the liability of LLC members is generally limited to the value of any agreed upon contributions. This type of organization may be managed by the members – all members share responsibility of the day-to-day operation of the business – or by a manager who has both the power to manage the business and the apparent authority to bind the business with written contracts.

There are three aspects of the LLC that are attractive for new businesses: (1) it can be taxed as a partnership, as a corporation (if such an election is granted by the IRS), or as a disregarded entity if there is only a single member; (2) it is an extremely flexible form of business, both in terms of options when creating the business and options about how it is to operate; and (3) it offers all members limited liability.

Generally, transfer of LLC membership operates only to transfer the economic rights, unless the remaining members unanimously agree to accept the transferee as a substitute member. The right of members to withdraw and the consequences of a withdrawal are issues that should be specifically considered and agreed upon in advance and spelled out in the operating agreement. Once dissolution is triggered, most state statutes follow the corporate model governing the winding up and termination of the business.

Farmers and ranchers have a number of organizational structures available for asset ownership and business operations. The Risk Concepts series of factsheets summarize key aspects of each organizational type. The documents are designed to help farmers and ranchers better understand key similarities and differences of the more common organizational structures. However, business owners should seek professional counsel from a knowledgeable attorney before deciding which organizational structure will work best to help them meet their goals.

~ Other RightRisk News ~

News Release - August 23 | RightRisk

AG CREDIT: Credit Conditions Moderate

AGRICULTURAL CREDIT CONDITIONS in the Tenth District moderated in the second quarter and farmland values continued to increase. Following multiple years of considerable improvement, farm income softened, and borrower liquidity retracted somewhat . . .

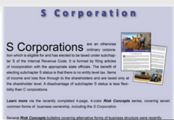
For more see: RightRisk.org\News

Highlighted Publication: *Risk Concepts*

The *Risk Concepts* series consists of seven bulletins covering various forms of partnerships, limited liability companies, corporations, as well as sole proprietorships. Each of the six most common forms of business ownership are compared across six characteristics of greatest importance to most farm and ranch families.

Selection between these alternatives has broad implications for how management decisions are made, the liability individuals may have when things go wrong, tax implications and level of taxation for owners, how to accommodate new owners or family members, implications for sustaining operations into the future, transfer of ownership, and ease of dissolution. The Risk Concepts summary chart can help.

To access the *Risk Concepts* series see **RightRisk.org\RiskConcepts.**



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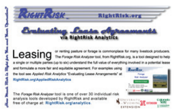
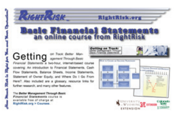
S Corporation



August 3 | Social Media Post
Evaluating Lease Agreements via Right-Risk Analytics



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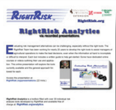
Basic Financial Statements



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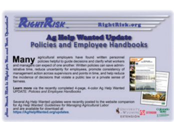

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Policies and Employee Handbooks

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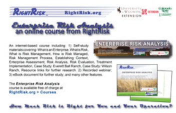

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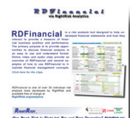
Enterprise Risk Analysis



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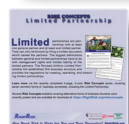
RDFinancial | RightRisk



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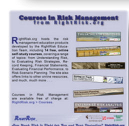
Limited Partnership



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RightRisk News is brought to you by the RightRisk Team

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How much risk is right for you and your operation?

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