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RIGHTRISK ...

RIGHTRISK NEWS

Limited Liability Company or Subchapter S Corporation?

armers and ranchers often create a legal entity for ownership of their assets and business operations. The question is "Which form of ownership is best for me?" Two legal entities commonly created by today's farmers and ranchers are Limited Liability Company (LLC) and subchapter S Corporation (S Corp). Let's take a brief look at the various attributes of these two forms of business and asset ownership. Please remember that you should seek professional legal and tax advice before forming any type of legal entity.

The LLC is a creature of statute, recognized only by virtue of a legislative enactment in each state. Owners are known as members. An S Corp is an ordinary corporation taxed under subchapter S of the Internal Revenue Code. Owners are known as shareholders. Two major differences between a C Corporation and an S Corporation are that a Sub S Corporation (1) is limited to 75 shareholders and (2) there is no taxation at the entity level.

Formation

An LLC is formed by filing an organizational document, often called Articles of Organization, with the Secretary of State or another appropriate official. The Articles of Organization have

certain requirements which depend on the statutes of the state in which the LLC is formed.



An S Corp comes into existence when Articles of Incorporation, sometimes called the corporate charter, are filed with the Secretary of State or another appropriated state official. The articles of incorporation contain very basic information about the corporation and are not intended to govern the day-to-day operation of the business. Once the articles are filed, the organizers will typically meet to select the initial directors unless they were named in the articles, authorize the enactment of bylaws that will govern the day-to-day operations of the corporation, authorize the issuance of shares, and take whatever actions are necessary to get the corporation started.

Operations

LLCs have a streamlined organizational structure, without officers or boards of directors. Some state statutes require a written operating agreement. In most jurisdictions, however, an operating agreement is optional and is only required if the members wish to vary the default rules provided for in the state statutes. Some state statutes permit the operating agreement to be oral.

An LLC may be managed by the members or by a manager. Member-management means that all members share responsibility for the day-to-day operations and have the power to bind the company to ordinary business contracts. Manager-management means that the manager will have both the actual power to manage and the apparent authority to bind the business by acts which appear to be carrying on the ordinary course of the LLC's business. The manager may be either a member or a nonmember.

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For the S Corp, management authority is usually exercised by or under the authority of the board of directors. These directors are usually elected by the shareholders, and they are generally required to hold meetings at least annually. Some state statutes allow smaller corporations to elect to have shareholders retain management authority by including a provision to that effect in the corporation's articles of incorporation.

Liability

Generally, members of an LLC and owners of an S Corp have limited personal liability. They will be liable for the amount or value of any agreed-upon contributions, for any debt they have guaranteed or for which they have otherwise agreed to act as surety, and for any personal misconduct in which they engage.

Owners of an LLC or an S Corporation are likely to have liability if they "pierce the corporate veil". In such cases, the members or shareholders acted in a manner which is inconsistent with the recognition of the Company as a separate entity (such as by commingling personal and business funds, failing to appropriately document loans, and/or the Company was used in the furtherance of crime, to facilitate fraud, or to justify a similar wrong. Once the corporate veil is pierced, the business is no longer viewed as a separate legal entity.

Taxes

An LLC can be taxed as (1) a partnership, (2) a corporation, if such an election is granted by the Internal Revenue Service (IRS), or (3) a disregarded entity if there is only a single member. Under federal law, LLCs having one member are taxed as sole proprietorships. Some state statutes impose a specific tax status on LLCs, regardless of how they might be classified for federal income tax purposes.

Members of the LLC may establish rules governing the allocation of profits and losses. Allocations may be modified to provide for per capita allocations, to be based on relative value of contributions, to be based on ownership interests or percentages, or otherwise. Moreover, state law does not restrict the right of parties to allocate distinct items of gain and loss differently from the members' usual sharing ratios.

An S Corp is an otherwise ordinary corporation taxed under subchapter S of the Internal Revenue Code. Generally, an S Corp is taxed as a "pass through entity". Some important attributes of subchapter S are that: (1) there will be no corporate income tax imposed; (2) shareholders will be taxed on amounts allocated to them; and (3) special allocations of income or loss are prohibited.

Ownership Transfer

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 such withdrawal are issues that should be specifically considered and agreed upon in advance and spelled out in the operating agreement.

Shareholders in an S Corp may sell or otherwise convey shares at any time to any other legal person. Buyers or transferees become a shareholder; with all the rights such a position entails. However, the shareholders may want to limit the rights of shareholders to freely transfer their shares. They may be concerned that such sales might violate the federal or state securities laws; sales to too many shareholders may deny a corporation its subchapter S status; or sales to certain potential shareholders may cause control of the business to get away from those who have an immediate connection with the business. Any limitations to shareholder sales should be reasonable and included in the corporate charter.

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Dissolution

There may come a time when a business is to be dissolved. Most states have default rules governing dissolution or the rights of LLC members to waive an event triggering

dissolution. Dissolution 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.



The process of terminating an S Corp is spelled out in the corporate statutes. Most of these rules are mandatory and cannot be circumvented by the agreement of the parties. Although there is a five-year statute of limitations for contingent claims in most state corporate statutes, this does not mean that the corporation must continue the winding up process for this entire period of time.

In choosing the best legal entity in which to own and operate your business, it is critical that you seek competent legal and tax advice along with good information on

the positives and negatives of each alternative.

The RightRisk Team published a series of fact sheets describing the basics of seven different organizational structures for farm and ranch businesses. Additionally, a chart compares the seven types of organizations and summarizes key aspects of each. All eight documents are available on-line, free of charge, at **RightRisk.org/RiskConcepts**.

	Sole Proprietor	C Corporation	S Corporation	General Partnership	Limited Partnership	Limited Liability Partnership	Limited Liability Company
Liability	Sole proprietors are personally liable for all debts of the business Sole proprietors are personally liable for any legal issues and lawsuits brought against the business	Liability is limited for all shareholders. Shareholders are liable for the agreed-upon value of their contribution Personal liability may arise where the courts generally agree that the corporation has been used in the furtherance of crime, to facilitate fraud, or to justify similar wrongdoing.	Liability is limited for all shareholders Shareholders are liable for the agreed upon value of their contribution Personal liability may arise where the courts generally agree that the corporation has been used in the furtherance of crime, to facilitate fraud, or to justify similar wrongdoing	General partners share personal liability for all debts of the partnership	General partners share personal liability for all debts of the partnership. Limited partners do share in the liability for partner- ship debt up to the value of their contribution	Partners have no personal liability for certain debts of the partnership State statures are divided about the amount of protection from personal liabili- ty offered to general partners	Members have no personal liability beyond the agreed upon value of their contributions. Personal liability may arise where the courts agree that the members acted in a manner incrosistent with LLC operation as a separate entity, such as commiging personal and business funds, falling to document loans to /from the entity, etc.
Taxes	Sole proprietors have no separate tax status. They are recognized by the Internal Revenue Service as an extension of the owner	Net income reported at the entity-level is subject to taxation Earnings distributed to shareholders are subject to personal income tax	No entity-level taxation, tax liability flows through to shareholders	No entity-level taxation, tax liability flows through to the partness	No entity-level taxostion, tax liability flows through to the partners Unless specified, partners are assumed to share in the profits and losses in accordance with each partner's interest. May elect to be taxed as a partnership or as a corporation.	No entity-level taxation, tax liability flows through to the partners Unless specified, partners are assumed to share in the profits and losses in accordance with each partner's interest.	LLCs with two or more members are presumed to be taxed as partnerships. Any given LLC may elect to be taxed as a corporation. State rules vary considerably but every state allows an LLC to extabilish rules governing the allocation of profits and losses.
Ownership Transfer	The sole propri- etor includes all property in his/ her individual estate plan	Shareholders may sell or otherwise convey shares at any time to any other legal person Buyers or transferees become a shareholder, with all the rights such a position entails	Shareholders may sell or otherwise convey shares at any time to any other legal person Buyers or transferees become a shareholder, with all the rights such a position entails	Partners are generally not entitled to transfer ownership to any other person, without the unanimous consent of all other partners New partners may be admitted by unanimous consent.	Partners are generally not entitled to transfer ownership to any other person, without the unan- imous consent of all other partners Partners may admit new partners by unanimous consent	Partners are generally not entitled to transfer ownership to any other person, without the unanimous consent of all other partners Partners may admit new partners by unanimous consent	Generally, transfer of LLC mem- bership operates only to transfer the economic rights, unless the remaining members unanimously agree to accept the transferee as a substitute member
Dissolution	A sole proprietor- ship terminates when the owner. 1. sells the business-related assets 2. gifts the business related assets to another person 3. dies	The process of terminating a corporation is spelled out in corporate statutes Most rules are mandatory and cannot be circumvented by agreement of the parties The parties The process of termination is spelled by agreement of the parties The parties of the pa	The process of terminating a corporation is spelled out in corporate statutes Most rules are mandatory and cannot be circumvented by agreement of the parties	Dissolution of a general partnership begins when a partner withdraws due to retirement, announces an intent to withdraw, dies, is incapacitat- ed, or is removed by the other partners	Partners have significant flexibility in determining when the limited partner- ship dissolves Generally, only general partners may supervise the process of dissolution	Dissolution of an LLP begins when a partner withdraws due to retirement, announces an intent to withdraw, dies, is incapacitated, or is removed by the other partners	The right of members to withdraw and the corresquences of such withdrawal are issues that probably 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.

~ OTHER RIGHTRISK NEWS ~

News Release - December 11 | RightRisk

Federal Reserve Beige Book Summary on the Ag Sector

ON BALANCE, economic activity slowed since the previous report, with four Districts reporting modest growth, two indicating conditions were flat to slightly down, and six noting slight declines in activity. Agriculture conditions were steady to slightly up as farmers reported higher selling prices; yields were mixed . . .



For more see: RightRisk.org\News

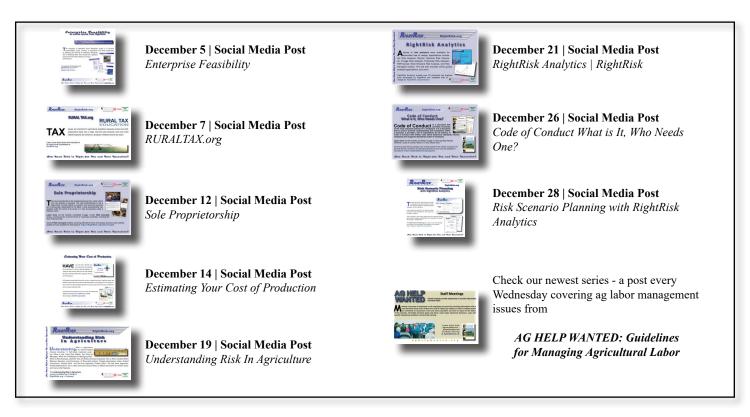
HIGHLIGHTED PUBLICATIONS: AG HELP WANTED UPDATES

What is the Fair Labor Standards Act in Agriculture and How Does it Apply to Me?

The Fair Labor Standards Act (FLSA) establishes minimum wage, overtime pay, recordkeeping, and youth employment standards affecting employees in the private sector and in federal, state, and local governments. Nonexempt workers covered under the Act are entitled to a minimum wage. Overtime pay must be paid at a rate not less than one and one-half times the regular rate of pay after 40 hours of work in a single workweek. Wages required by the FLSA are due on the regular payday for the pay period covered. Deductions made from wages for such items as cash or merchandise shortages, employer-required uniforms, and tools of the trade, are not legal to the extent that they reduce the wages of employees below the minimum rate required by the FLSA or reduce the amount of overtime pay due under the FLSA. The FLSA contains some exemptions from these basic standards. Ag Help Wanted Updates can help you better understand these details.



To access the publication see: AgHelpWanted.org\Updates.



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How much risk is right for you and your operation?





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