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R I G H T R I S K N E W S

L i m i t e d L i a b i l i t y C o m p a n y o r S u b c h a p t e r S C o r p o r a t i o n ?

Farmers 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.





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



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