Farm Business Structures: Pros and Cons of Each

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Choosing a business structure for a farming business can be difficult because entities differ in tax and legal implications. Choosing a business structure for the farm operation could result in either beneficial or negative consequences. This guide will discuss the most commonly used business entities used for farming operations and discuss the pros and cons of each. This guide is designed to serve as a place to start prior to discussions with an attorney or accountant.

Sole Proprietor

A sole proprietorship is a business that is owned and operated by a single individual who is the sole beneficiary of all profits or risks and responsible for all risks.

Pros of Sole Proprietorships

- Sole recipient of profits and losses.
- No filing process (unless hiring an employee).
- Easy and inexpensive to set up.
- Unconditional and full control of operations.
- Not required to operate a separate bank account.
- Confidentiality of information.
- No retitling of registered vehicles (trucks, tractor trailers, tractors, etc.).
- Can cease operations at owners' discretion.
- Easy to change business model.

Cons of Sole Proprietorships

- Unlimited liability.
- Limited managerial ability. A sole proprietor is responsible for all managerial functions. May not be able to attract and retain employees.
- No income taxes are taken out of income in comparison to being an employee who receives a W-2.
- Owner and business are the same entity; therefore, the life of the business is limited because of death, insolvency, or illness.

Partnership

A partnership is a business with two or more owners who share the responsibilities involved with running the business, as well as the assets, profits, financial liabilities, and legal liabilities of a jointly owned business. Partnerships are considered a pass-through entity as partners pay tax liabilities personally.

Pros of Partnerships

- Governed by a partnership agreement.
- Easy and inexpensive to set up.
- Simple to dissolve.
- Partners can share tasks, allowing greater work-life balance.
- Ability to pool resources between partners.
- Pays no income tax because it is a pass-through entity.
- No external financial reporting or annual report is required.
- Can cease operations at owners' discretion.
- Easy to change business model.

Cons of Partnerships

- Personal liability is unlimited. Partners must deal with the financial and legal consequences of each other's actions.

- Partners may bring additional debts and liabilities.
- Potential difficulty making decisions unilaterally.
- Potential difficulty to reach agreements about selling or exiting the business.
- As the business grows, it can become complicated and outgrow the partnership structure.

Limited Liability Company – Single Member

The LLC, which stands for Limited Liability Company is one of the most common small business structures. A sole individual or multiple individuals can own an LLC. Individuals with ownership in an LLC are called members. The pros and cons of a single-member LLC and a multi-member LLC can be slightly different. In a single-member LLC, the member is responsible for managing the operations of the business and paying necessary taxes.

Pros of Single Member LLC

- Recognition as a legitimate business, separate from the owner.
- Limited liability and may qualify for reduced insurance rates.
- Member manages and controls all aspects of the company.
- Separates business and personal finances.
- All income and expenses are reported on personal 1040.
- Can choose to be taxed as other entities.

Cons of Single Member LLC

- The formation process requires a lot of paperwork and associated fees.
- Existing loans for liabilities need to be redone in LLC.
- Must meet compliance, recordkeeping, and other ongoing state requirements.
- All vehicles need to be reregistered in the LLC name.
- The court system is still determining how to evaluate the liability protection of LLC.

Limited Liability Company – Multiple Member

The multiple member LLC is owned by more than one individual, called members. This entity is a pass-through entity because it passes income, credits, deductions, and losses directly to its members. Members pay income taxes personally. This entity combines the flexibility of a partnership with the liability of an LLC.

Pros of Multiple Member LLC

- Limited liability and may qualify for reduced insurance rates.
- Ability to pool resources of members.
- Members can share tasks, allowing greater work-life balance.
- Separates business and personal finances.
- Governed by an operating agreement.
- Can have unlimited members as long as operating as a partnership.
- Can choose to be taxed as other entities.

Cons of Multiple Member LLC

- The formation process requires a lot of paperwork and associated fees.
- Existing loans for liabilities need to be redone in LLC.
- Must meet compliance, recordkeeping, and other ongoing state requirements.
- All vehicles need to be reregistered in the LLC name.
- The court system is still determining how to evaluate the liability protection of LLC.

S-Corporation

An S-corporation is considered a pass-through entity because it pays no corporate taxes. Profits/losses are passed to its shareholders, who are responsible for taxes due at their personal tax rate.

Pros of S-Corporation

- Prestige and credibility of being a corporation.
- No double taxation for shareholders.
- Profits passed through to shareholders are not subject to self-employment taxes.
- Offers limited liability protection. Owners personal assets cannot be accessed by legal claims or business creditors against the company.

Cons of S-Corporation

- The formation process requires a substantial amount of paperwork and associated fees.
- Existing loans for assets and registrations need to be redone.
- Must meet compliance, recordkeeping, and other state requirements, as well as separate IRS income tax form filings.
- Loss of flexibility in withdrawing funds for personal use. Distributions cannot be used in place of a "reasonable" salary.
- IRS requires all s-corporation shareholders who are actively involved in running the business a "reasonable" salary.

C-Corporation

A C-Corporation is a stand-alone legal structure in which the shareholders, or owners, are taxed separately from the entity.

Pros of C-Corporation

- Prestige and credibility of being a corporation.
- Legally separates shareholders' assets from that of the corporation.
- Shareholders are not liable for the company's obligations and debts.
- An unlimited number of shareholders.
- Can continue to operate if the ownership or management changes.
- The corporate tax rate may be lower than the shareholders' individual tax rate under the current tax code.

Cons of C-Corporation

- The formation process requires a substantial amount of paperwork and associated fees.
- Shareholders cannot deduct losses, and business profits are double taxed.
- Dividends issued.
- Excess cash retained in a corporation can be difficult to access without creating a taxable event.
- Subject to greater regulation than other business structures, potentially incurring high accounting and legal fees.

Summary

This list of pros and cons for each business structure is not comprehensive. Some business structures may be more beneficial to a farm business than others. It is highly recommended to consult with both an accountant and an attorney to determine which entity might be the best suited for the farming business.

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