

## Business Structures Information Sheet

Business structure plays a role in farm transfer so it is important to understand what the different kinds of entities are. It is especially important if the transfer involves some or all aspects of the farm or ranch business, not only land and other real estate assets. There are four main types of business structure: Sole proprietorships, partnerships, Limited Liability Companies, and Corporations including cooperatives and nonprofits. This information sheet briefly summarizes what they are.

**Sole Proprietorship:** In a sole proprietorship, the business is owned and run by one person. Legally there is no difference between the owner and the business. Sole proprietorships are the simplest and cheapest type of business to create. But they have “unlimited liability” which means they do not offer the owner any legal protections for personal assets. This leaves the owner solely responsible for all business activity, including lawsuits and debt. Sole proprietorships are “pass through” or “flow through” entities, which means that business income is treated as the owner’s income and is reported on the owner’s personal tax return.

Because assets are undivided in a sole proprietorship, it may be more difficult for an owner to transfer individual assets to different people. This makes it challenging and time consuming for the owner to create a transfer plan that involves multiple successors

**Partnership:** Partnerships are the simplest way to allow two or more people to be in business together. Also pass through entities, in partnerships owners may have equal power and share profits and losses (General Partnerships) or one main partner may play the primary role managing the business and daily operations (Limited Partnerships). Typically, profits and losses are shared between partners based on the amount of their involvement in the business.

It is easier to transfer individual assets gradually in a partnership than a sole proprietorship. Assets can be sold, gifted, or passed through an estate over time. Stretching out the transfer of assets can spread out income and reduce taxes, lowering the capital needs of the incoming producer and making it possible for them to acquire assets over time.

**Limited Liability Company (LLC):** An LLC is another pass through entity but unlike sole proprietorships and partnerships, the business entity is separate from its owners. LLCs are fairly easy to create and provide limited liability so they protect owners from lawsuits and debt.

LLCs often are the structure of choice for a farm or ranch business because they offer protections but are flexible and a good way to transfer both management and ownership.

**Corporations:** Corporations are organizations, usually a group of people or a company, authorized by the state to act as a single entity and recognized by law. They are owned by stockholders or shareholders who share the profits and losses generated by the business operation. Because they are separate from their owners, they are taxed separately. Owners are not personally liable for company debt, and their personal assets are not at risk if the company fails or is sued. There are several types of corporations including C Corps which are usually large corporations, and S Corps which only allow up to 100 shareholders and provide for pass through income, so are the usual option for most farm or ranch businesses. Cooperatives or co-ops also are corporations but are owned and operated by the employees or people who use the product or service the business produces. They are managed equally by the owners and profits are distributed equally among all members. Finally, nonprofits are considered corporations because they are required to file articles of incorporation in the state where they are registered. At the same time, they are considered non-business entities because their purpose is to serve a charitable mission or cause, and not to earn profit. They may be exempt from paying federal income taxes by claiming 501(c) status with the IRS.

A corporate structure can help with the process of transferring a farm business to the next generation. Shares can be sold, gifted, or passed through an estate as a way to transfer the business, eliminating the need to transfer separate, individual assets and spreading out income (and taxes) for the owner. This makes it easier for the incoming producer to acquire assets over time, reducing their need for large amounts of capital.