

Structuring Your Farm Business

A law bulletin series on using business entities for farms



A Comparison of Business Entities Available to Ohio Farmers

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Ohio farmers have many choices when selecting a business entity for their farming operations. Choosing the right entity is important, as it can impact issues such as how the business functions, ownership rights, personal liability, and taxation. What should a farmer consider when deciding which type of entity to use for a business? We provide an overview of business entities used for farm operations in this bulletin, compare ten important factors to consider when making the entity selection decision, and highlight the advantages of using a formal business entity. A **Business Entity Comparison Chart** at the end of the publication summarizes entity characteristics. As with all legal issues, consultation with an attorney is critical to making a successful decision.

Types of business entities

Sole Proprietorship. A Sole Proprietorship is a business owned by a single person who is referred to as the “sole proprietor.” The sole proprietor and the business are one and the same—there is no separate legal business entity. The sole proprietor owns all business assets, is responsible for all liabilities, and reports income as individual income.

Partnership. A partnership exists when two or more individuals or “partners” jointly own and conduct a business for profit. A “General Partnership” consists of partners who each have management authority and personal liability for the partnership and who report income from the



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partnership as individual income. A different type of partnership, the “Limited Partnership,” allows investors to enter a partnership as “limited partners” without involving them in management and exposing them to personal liability for the partnership.

Corporation. A for-profit corporation is a legal “person” separate from the individuals who own it. This legal separation protects owners from personal liability for the business and sets up taxation of the corporation’s income. The owners are “shareholders” in the business, while management is through a formal structure such as board of directors and elected officers. There are two types of corporations: an S-Corporation (S-Corp) and a C-Corporation (C-Corp), named after Internal Revenue Code provisions that address taxation of the corporation and its shareholders.

Limited Liability Company (LLC). An LLC is the newest type of business entity, and it combines management and tax characteristics of a partnership with the personal liability protection of a corporation. One or more “members” are the owners, all of whom are shielded from the LLC’s liabilities. An LLC can potentially elect to be taxed as a Sole Proprietorship (single member), Partnership (multiple members), C-Corp or S-Corp. An LLC’s members usually operate the entity less formally than a Corporation and more like a Partnership.

Factors for selecting a business entity

1. Formation requirements

Certain entities must follow formal legal procedures before conducting business, while others are not subject to any formal requirements and can operate without taking formation steps.

- A Limited Partnership, LLC, and Corporation must **register** with the Ohio Secretary of State by filing “Articles of Incorporation/Organization”, naming a statutory agent to receive legal notices for the entity and submitting a filing fee. The Secretary of State’s office reviews and approves the documents and the entity’s proposed name.
- A Sole Proprietorship has no formal registration requirements.
- A General Partnership is not required to register with the State but may file a “Statement of Partnership Authority” that identifies those partners who may act on behalf of the General Partnership. This clarification of partnership authority is helpful to other businesses who work with a General Partnership.

2. Governing documents

A governing document establishes how an entity will function and operate, addressing important issues such as voting procedures, meetings, identity and role of managers, distribution of income, taxation, and more. We use different names for these documents. A Partnership uses a “Partnership Agreement,” a Corporation uses “Bylaws,” and an LLC uses an “Operating Agreement.” While Ohio law does not require any type of business entity to have a governing document, every entity other than a Sole Proprietorship should have a governing document. Otherwise, Ohio laws will

control any governance issues that arise with the business. A well-written governing document developed in consultation with an attorney will provide certainty and guidance for any entity.

3. Cost of creation

The cost of creating a business entity can include registration fees and preparation of governing and other documents, but requirements vary based on the type of entity.

- The Sole Proprietorship is the only entity with no registration or creation costs.
- A Limited Partnership and an LLC will have initial registration fees, as will a General Partnership that chooses to file a Statement of Partnership Authority. These entities will also have costs in establishing their governing documents.
- A Corporation is likely to have the highest cost of creation because it must register with the State, should have governing Bylaws drafted by an attorney, and could have the additional cost of establishing and distributing stock to shareholders.

4. Number of owners

Requirements and limitations on the number of owners vary according to the type of entity.

- A Sole Proprietorship, by definition, has only one owner.
- Partnerships must have at least two owners.
- An LLC or C-Corp can have any number of owners, including single owners.
- An S-Corp or LLC taxed as an S-Corp can have no more than 100 owners and those owners cannot be partnerships, corporations, non-resident aliens or certain types of trusts.

5. Personal liability of owners

Owners of certain entities have high personal liability exposure and can be liable for the business, while Ohio law protects other types of entity owners from personal liability.

- Sole proprietors and general partners are personally liable for their business entities.
- A limited partner in a Limited Partnership is not personally liable for the Partnership.
- LLC and Corporation owners are not personally liable for the entity's obligations, although legal exceptions might apply to a particular situation that may lead to personal liability.
- See the bulletin on *Using Entities to Manage Farm Liability Exposure* for a thorough discussion of liability and business entities.

6. Income taxation

The type of business entity determines whether income taxes are assessed on the entity, its owners, or both the entity and its owners.

- For a Sole Proprietorship, Partnership, and S-Corp, income “passes through” to the owners, who pay their individual tax rates on the income. The entity does not pay taxes.
- A C-Corp pays the corporate tax rate on all corporate income, and its shareholders are taxed individually on their dividends from the corporation.

- An LLC can choose how it will be taxed. It can be taxed as a Sole Proprietor if it has only one member, a Partnership if it has at least two members, a C-Corp, or an S-Corp. If no tax election is made, a single-member LLC is taxed as a Sole Proprietorship and a multi-member LLC is taxed as a Partnership.
- See our bulletin *Tax Characteristics of Business Entities Available to Ohio Farmers* in this series for a thorough discussion of tax issues for business entities.

7. Management

How an entity is managed is also an important consideration, and some entities allow for a less formal management structure.

- Management of a Sole Proprietorship or a single member LLC is simple, with the owner serving as the manager and having full management control.
- In a General Partnership, all partners can be involved in management, but limited partners are not involved in managing a Limited Partnership.
- An LLC is flexible and can be managed by all members or by a designated manager.
- The most formal and complex management structure is the Corporation, with management by a board of directors and/or elected officers.

8. Raising capital

A Corporation has the unique option of selling shares of stock to raise capital for the business. Other entities typically raise capital through owner contributions, and an LLC may sell ownership interests.

9. Transfer of ownership

Partnerships, Corporations, and LLCs can restrict ownership transfers within their governing documents or other legal documents. These documents can also give existing owners the right to buy another's ownership interest so it is not transferred to a non-owner.

10. Dissolution and liquidation

Paperwork and tax requirements for termination or dissolution of an entity vary.

- A Limited Partnership, Corporation, and LLC must file paperwork and a fee with the Secretary of State, while a Sole Proprietorship or non-registered General Partnership does not have to file paperwork to terminate the business.
- A Sole Proprietorship, Partnership, or LLC taxed as a Partnership usually has no tax due on the liquidation or transfer of assets out of the entity.
- A C-Corp must treat a liquidation and transfer of assets as a sale, which requires taxes to be paid at both the corporate and shareholder level.
- An S-Corp must also treat a liquidation or transfer of assets as a sale, but taxes are due only at the shareholder level.

Advantages of formal business entities

As the above information illustrates, there are many differences among the different types of business entities available to farm operations. It is critical to understand, however, that operating as a formal business entity can be advantageous to a farm. Even so, the 2017 Census of Agriculture suggests that most farmers choose to operate as Sole Proprietors, with only about 12% of farms stating they are taxed as a Partnership or Corporation.

Sole Proprietorships have two primary disadvantages compared to formal business entities. First, they do not provide liability protection. If the owner or an employee working for the Sole Proprietorship creates a liability issue, all of the owner's business and personal assets are at risk. The second disadvantage is a Sole Proprietorship must file a Schedule F for income taxes and is not eligible for some of the tax benefits a Corporation tax structure can provide.

There are four primary factors that weigh in favor of using a formal business entity rather than a Sole Proprietorship for a farm operation.

1. **Liability protection.** Limited Liability Companies (LLC) and Corporations provide liability protection to the owners. The liabilities created by an LLC or Corporation is not automatically transferred to the owners. These entities provide a liability shield between the entity and owners.
2. **Tax structure.** Partnerships and Corporations have taxation benefits that are not available to an Sole Proprietorship. For example, many farms are taxed as corporations to reduce self-employment tax or provide fringe benefits to the owners. LLCs can be taxed either as Partnerships or Corporations.
3. **Consolidation of ownership.** Farm families not farming within a business entity will often have an irregular compilation of ownership for the farming assets. Farm machinery and livestock may be owned by various family members in various proportions. Entities can be used to consolidate ownership of the assets and make for easier management.
4. **Formalized multi-ownership.** Business operating agreements such as partnership agreements, corporate bylaws or LLC operating agreements can establish voting, management and ownership rules among the owners, help avoid conflicts, and resolve conflicts when they do arise.

Seek legal and tax counsel

Each business situation is unique. Seeking the advice of an attorney and tax advisor can help ensure that a farm business chooses the best entity and tax structure for its individual situation.

BUSINESS ENTITY COMPARISON CHART

	Sole Proprietorship (SP)	General Partnership (GP)	Limited Partnership (LP)	Limited Liability Company (LLC)	Corporation (Corp)
Definition	A person operating in their personal capacity who owns all assets and owes all liabilities.	A voluntary association of two or more persons who jointly own and conduct a business for profit.	A partnership with that includes limited partners who have limited liability and management authority.	An entity with limited liability for its owners, income tax election options, and flexible management structure.	An entity that is legally distinct from its owners, with liability protection, tax options, and formal management
Term used for owners	Sole proprietor	General partners	General and limited partners	Members	Shareholders
Formation requirements	No formal requirements.	No formal requirements.	Register with state.	Register with state.	Register with state.
Governing documents	None	Partnership agreement	Articles of Incorporation and partnership agreement	Articles of Incorporation and operating agreement	Articles of Incorporation and bylaws
Cost of Creation	None	None or low	Moderate	Moderate	High
Number of owners	One	Unlimited	Unlimited	Unlimited	Unlimited, except 100 shareholders for S-Corp.
Personal liability of owners	Personal liability for entity obligations.	Personal liability for entity obligations.	Personal liability for general partner(s); no personal liability for limited partners.	No personal liability for entity obligations.	No personal liability for entity obligations.
Taxation	Pass-through to individual.	Pass-through to individual.	Pass-through to individual.	Can pass-through or elect taxation as at corporation level.	Tax at corporation and individual level unless S. Corp, then only to individual level
Applicable tax rates	Individual tax rate.	Individual tax rate.	Individual tax rate.	Individual tax rate if taxed as partnership; otherwise, corporation tax rates.	Corporate tax rates for C- Corp; tax rates of shareholders for S-Corp.

BUSINESS ENTITY COMPARISON CHART (continued)

	Sole Proprietorship (SP)	General Partnership (GP)	Limited Partnership (LP)	Limited Liability Company (LLC)	Corporation (Corp)
Management	Sole proprietor has full control.	Typically, each partner has management authority.	General partners manage, limited partners have limited or no management authority.	Either by all members or by a designated member manager.	Board of directors elected by shareholders; officers elected by directors.
Raising capital	Owner contributions.	Owner contributions.	Owner contributions.	Owner contributions or sale of interest.	Sale of stock.
Transfer of ownership	Freely transferable.	May be limitations, controlled by partnership agreement.	May be limitations, controlled by partnership agreement.	May be limitations; controlled by operating agreement.	May be limitations; controlled by bylaws or share purchase agreement.
Termination or dissolution	No filing required.	Filing required.	Filing required.	Filing required.	Filing required.
Tax treatment of liquidation or transfer of assets	No tax.	Generally, no tax.	Generally, no tax.	Generally, no tax if taxed as a partnership; corporate and shareholder level taxes likely if taxed as a corporation.	Generally, corporate and shareholder level taxes for C-Corp, tax only at shareholder level for S-Corp.

The *Structuring Your Farm Business* bulletin series is a project of the **OSU Agricultural & Resource Law Program**. Find other law bulletins in this series and all our resources on OSU's Farm Office website, a one-stop shop for agricultural law and farm management information.



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