FARM COMMONS

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Forming an LLC for Your Farm Basics

FAQs on whether a limited liability company (LLC) is the right business structure for a farm or ranch operation.

Why LLC?

Should I form an LLC for my farm business?

Creating and maintaining a Limited Liability Company (LLC) for your farm business requires some extra effort and expense. How do you know if it's worth it? A wise approach is to consider whether the benefits outweigh the costs. With this in mind, answer the following questions to help you determine whether the LLC entity may be right for you and your farm.

What benefits does the LLC offer?

Personal liability protection

I'm concerned that if my farm business experiences financial troubles or a lawsuit I might lose everything

☐ Yes

☐ No

A significant benefit of a formal business entity such as an LLC is that the entity can protect the owners'— or members' in LLC lingo—personal assets from the farm business' liabilities. With an LLC, the members' risk is limited to the amount that they invest in the farm business. No more, no less.

Caution: The LLC's protection from personal liability is not absolute

If the farm business does not follow certain standards and practices, courts can reach around the LLC's personal liability shield and allow creditors to access individual members' personal assets. Basically, if the members don't take the entity seriously neither will the courts.

Resilient partnerships

I'd like to establish clear expectations with my farm business partner(s) so our relationship stays on solid ground

☐ Yes

☐ No

The process of forming an entity such as an LLC provides business owners the opportunity to consider and agree upon significant issues upfront— including identifying expectations and shared goals. This can help the owners maintain open communications, which can lead to less headaches and disagreements down the road.

Flexibility

I want to establish a collaborative or unique organizational structure for my farm business

☐ Yes

☐ No

Unlike C Corporations, the LLC allows for a lot of flexibility in how the business is structured and operated. For example, voting rights can be based on one person, one vote just like a cooperative. Or, various classes of membership can be established where some have voting rights and some don't. LLCs also allow flexibility for how to allocate profits and losses. The options are pretty much unlimited.

Efficient management I could sure use better systems to help streamline certain administrative and management aspects of my farm business

☐ Yes

☐ No

The formalities of the LLC entity can in and of itself help promote good business practices. For example, when drafting the LLC operating agreement, the owners will need to set clear parameters for how management decisions are made. This can help prevent stalemates later on. Also, the owners must keep their personal and farm business financial affairs separate (e.g., separate bank accounts and credit cards). By default, the LLC will need to establish its own accounting systems, which can make it easier to keep all the books and records in order.

Fundraising potential

I need to raise funds for my farm business or may want to bring in other partners

☐ Yes

☐ No

Having the framework and integrity of a formal business entity such as an LLC can help the farm business raise funds from outside investors. This includes obtaining loans from banking institutions. It could also include bringing on other partners who want to invest money or offer something of value such as land or their services in exchange for ownership interests in the company.

Succession planning

I want to create a smooth way to pass on my farm business to my children or other successors

☐ Yes

☐ No

The LLC provides a flexible and effective way to transfer the farm business as a whole rather than individual assets. It can also provide more favorable tax benefits. For example, if the family farmland is placed in ownership of a formal business entity such as an LLC, it may be insulated from higher estate taxes if the heirs are properly named as members of the entity itself.

Potential tax benefits

I anticipate making more income than the average farmer in my situation and want to take advantage of potential tax breaks

☐ Yes

☐ No

By forming an LLC, a farmer may be eligible to reduce the self-employment (SE) tax for any business income that is above and beyond what an average farmer makes. That's because when you have an LLC entity you have the option of selecting the S Corporation tax status with the federal IRS. The S Corporation handles self-employment taxes slightly differently than a pass through entity (i.e., sole proprietorship or general partnership).

LLC Benefits

Are the benefits of an LLC worth the expenses and efforts?

If you answered YES to any one or more of the above questions, forming an LLC may be right for your farm. Now the question remains: Are you willing to do what it takes to create and maintain the LLC entity? Here's the lowdown of what's required.

Filing paperwork and paying fees

To form an LLC, you must file Articles of Organization accompanied by the appropriate filing fee with your state agency—the Secretary of State in Minnesota and the Department of Financial Institutions in Wisconsin. The Articles of Organization is a pretty simple document that includes names and addresses of the members and some other basic information.

In Minnesota, filing fees are $155 with expedited service for online and in-person submissions and $135 for paper filings submitted by mail. You must also file an annual renewal form every year, which is due by December 31. There is no fee for filing the annual renewal if the entity is active and in good standing.

In Wisconsin, fees are $130 for online filings through the QuickStart LLC platform and $170 for paper filings submitted by mail. You must also file an annual report form every year and submit a fee of $25.

Keeping business and personal financial affairs separate

It is essential that you maintain a clear and distinct level of separateness between the LLC's business affairs and the individual members' personal affairs. Primarily, this means maintaining separate bank accounts and accounting records. This also includes not paying personal debts or bills with the business assets.

Allocating assets to the LLC

Any land, equipment, or other asset that a member contributes to the LLC in exchange for ownership interests in the farm business needs to be formally transferred over. Officially allocating assets in this way helps make absolutely clear who owns what.

Creating and following through with the operating agreement

A lot of states do not require an LLC to have an operating agreement; however, just because it isn't required doesn't mean you shouldn't have one. Perhaps most importantly, the operating agreement lets the members create the governing rules and structure of the business. This includes taking advantage of the flexible aspects of the LLC entity. If there's no operating agreement in place, the state's default rules apply. For step-by-step guidance on writing an operating agreement for your LLC, use our Farmers' Workbook for Creating a Governance Document.

Filing and paying taxes

You'll need to be sure the LLC and each of its members fulfill the annual tax obligations. This includes distributing forms, filing forms, and, of course, paying taxes when due.

What is required depends on what tax designation the LLC entity chooses with the federal IRS. There are three options: S Corporation, C corporation, or pass through (default). If you elect the default status, the farm business will be taxed exactly like a sole proprietorship or general partnership. The LLC itself does not have to file a separate annual income tax return.

So now the final question:
I don't mind following through with the necessary formalities—including paying fees, filing annual reports, maintaining separate bank accounts, and doing some additional paperwork
☐ Yes
☐ No
If you answered yes, you may want to consider forming an LLC. For more information and useful tools to get you started—including a checklist for forming an LLC, annotated sample operating agreements, a checklist for creating an operating agreement, and sample annual meeting minutes—check out the chapter on LLCs in Farm Commons' resource Farmer's Guide to Business Structures.

Caution: An LLC is not a substitute for insurance
Creating an LLC does nothing to change the landscape of a farm's potential liability. It only limits the assets available to satisfy that liability, should it materialize, to business assets. All the farm's assets are entirely available to anyone with a successful claim against an LLC. Farm Commons strongly urges any farm business, no matter what business entity it adopts, to maintain adequate insurance coverage. Bottom line, good liability insurance provides the farm with a defense in court and a source of funds to pay out on a court claim if it is successful.

See our free **Farm Insurance Basics** guide for more guidance.

DISCLAIMER: This guide does not provide legal advice or establish an attorney-client relationship between the reader and author. Consult an attorney for advice specific to your situation and the state in which you operate.