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FOR FLORIDA'S AGRICULTURAL GROWERS, CHOICE OF ENTITY IS A KEY TO ECONOMIC SUCCESS

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Erratic commodities markets, consolidating distribution channels, and escalating costs of soil amendments are just some of the economic challenges facing Florida's farmers, ranchers, grove owners, and dairy operators. Especially for smaller, family-owned operations, the business of farming requires a focus on economic strategy, as well as agricultural sustainability. A successful agrarian enterprise requires wise corporate and financial decision-making.

Choosing the proper entity structure for a farm, ranch, citrus grove, or dairy operation is vital to securing financial protection, minimizing tax obligations, and maximizing growth potential for agricultural assets. As operations grow, so will the responsibilities associated with an operation's employees, including work-related injuries and other liabilities. At the same time, there are major government payments to account for and shifting markets that require risk protection.

COMMON ENTITY STRUCTURES

There are primarily seven entity structures used for Florida farms:

Sole proprietorship. This structure is straightforward — the business owner is the business, exposing them to any business liabilities. It offers no separation between personal and business assets, making it a risky choice of entity, especially for larger operations.

General partnership. A general partnership is formed when two or more individuals or entities carry on a business together for profit. Typically, all partners share equally in the management and profits, and, like a sole proprietorship, each partner has unlimited personal liability for the debts and obligations of the business, making it a riskier choice of entity.

Limited partnership (LP). A limited partnership consists of one or more general partners who manage the business and have unlimited liability and one or more limited partners who contribute capital to the business but have limited liability and little to no management authority.

Limited liability partnership (LLP). An LLP provides all partners with limited liability protection, meaning they are shielded from personal liability for the debts and obligations of the partnership arising from the acts of other partners or employees of the partnership. Unless otherwise specified in the partnership agreement, all partners in an LLP typically have the right to participate in the management and decision-making of the business.

Corporation. A corporation is a separate and distinct legal entity from its owners (shareholders). Corporations provide limited liability protection to shareholders but are subject to more complex legal and regulatory requirements.

By default, a corporation is taxed as a "C" corporation for federal income tax purposes, which subjects the business to two layers of taxation – one at the corporate level and again on dividends made to shareholders. However, if eligible, a corporation can elect to be taxed as an "S" corporation, which causes it to become a pass-through entity similar to a partnership. For S corporations, all income, losses, deductions, and credits pass through to the shareholders for tax purposes, thereby avoiding the federal corporate-level tax. S corporations are only allowed to have one class of stock, which may only be owned by individuals and certain trusts (and estates). Other types of entities (such as partnerships, other corporations, or LLCs) may not own shares in an S corporation. Moreover, an S corporation may not have more than 100 shareholders and profit distribution must be proportional to the shareholders' respective ownership stake in the business.

Limited liability company (LLC). LLCs are popular among small to medium-sized farms. They combine the liability protection of a corporation with the tax benefits of a partnership. Unlike a partnership, the LLC can have either one individual or entity serving as its owner (member) or multiple. The member(s) can also have the LLC taxed as an S corporation (assuming it meets the eligibility requirements described in the section above). The involvement level of the member(s) of the LLC can affect whether earnings are subject to self-employment taxes. Members of an LLC can choose to manage the company themselves (member-managed) or appoint a manager (or managers) to handle day-to-day operations (manager-managed).

Limited liability limited partnership (LLLP). An LLLP is a hybrid entity that combines the features of a LP with those of an LLC. Like a LP, an LLLP must have at least one general partner and one limited partner. Unlike an LP, however, even general partners enjoy limited liability protection. LLLPs also offer pass-through taxation and, like an LLC, flexibility in management structure. Unlike an LLC, however, an LLLP cannot elect to be taxed as an S corporation.

KEY CONSIDERATIONS

When it comes to deciding on an entity structure, farm, ranch, grove, and dairy owners should ask themselves:

- Is protection from legal liability a concern for the owner and/or partners?
- What are the tax implications of each entity type, given the needs and circumstances of the business owner(s)?
- What are the owner's needs regarding debt basis, which potentially enables owners to deduct losses?
- How do the owner and/or partners want the business to be managed, and how do they envision the division of roles, responsibilities, decision-making authority, etc.? How much flexibility is necessary?
- What are the legal and administrative requirements for forming and maintaining each entity type?
- Will it be difficult to transfer ownership interests in the business?
- Will it be challenging to raise capital and attract investors?

SPECIAL CONSIDERATIONS

A C corporation that later elects S corporation status must be mindful of the built-in gains tax over a five-year period. This tax applies if assets are sold at a gain present at the time of the S election. Additionally, all shareholders must qualify under S corporation requirements.

The benefits of electing S corporation status include eligibility for the qualified business income deduction and favorable long-term capital gains tax rates on real estate and other investments, which are unavailable under traditional C corporation treatment. Despite the tax benefits, the legal structure remains intact, providing ongoing corporate protections.

Corporate shareholders who are actively providing services to the corporation must pay themselves a reasonable salary for the services they provide. This salary is subject to self-employment tax.

In LPs or LLLPs, general partners are usually subject to self-employment tax on the entirety of their distributive share of partnership income.

RETAINING FLEXIBILITY TO CHANGE ENTITY STRUCTURES IF NECESSARY

As an agricultural operation evolves, its need for liability protection and effective tax management is also likely to grow. For instance, shifting from a sole proprietorship to an LLC or corporation can provide necessary asset protection as the business expands. Adjustments in the tax landscape or a change in the operation's financial strategy might also prompt a shift, like moving from a C corporation to an S corporation, to take advantage of more favorable tax treatments for pass-through income.

Choosing the right entity structure for an agricultural operation is more than a bureaucratic decision — it is a foundational strategy that impacts every aspect of the business from legal liability to tax obligations. Consulting with agricultural tax and corporate advisers can provide personalized advice, ensuring that the operation is structured in a way that aligns with current needs and future goals.

To learn more, contact the GrayRobinson national Food Law Team at 866.382.5132 or foodlaw@gray-robinson.com.

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