



“Building for the Successful Transition of Your Agricultural Business” Fact Sheet Series

A Comparison of Business Entities Available to Ohio Farmers

Robert Moore

Attorney, Wright Law Co., LPA, Dublin, Ohio

Barry Ward

Leader, Production Business Management, The Ohio State University

Ohio farmers have many choices when selecting a business entity for their farm operations. The choice of business entity affects liability, taxation, management, and succession planning. Therefore, selecting a business entity should be given a great deal of thought and attention. A brief overview of the various factors to consider when deciding on a business entity is presented here. The reader is encouraged to use this publication as a means to identify the many issues involved with selecting a business entity but is strongly encouraged to seek professional advice.

Formation

A Limited Partnership (LP), Limited Liability Corporation (LLC), and Corporation (Corp.) must file registration documents with the Ohio Secretary of State. Upon approval of the application, the Ohio Secretary of State issues a certificate to the entity acknowledging its legal status.

A Sole Proprietorship (SP) and General Partnership (GP) do not require any registration with the Secretary of State. Simply conducting business establishes the SP or GP.

Governing Documents

While governing documents are not required by Ohio state law, they are highly recommended for any business entity, other than an SP. The documents declare how the business is to be managed and operated, establish the initial owners, control how ownership transfer may occur, control how termination and liquidation of the company

are handled, and determine how disputes are resolved. If an entity does not have a governing document, the Ohio Revised Code controls.

Cost of Creation

A Sole Proprietorship has no cost of creation. A General Partnership may have a low cost of creation if a partnership agreement is drafted. A Limited Partnership and a Limited Liability Corporation will have medium to high start-up costs due to registering with the Secretary of State and drafting of governing documents. A Corporation will have the highest costs of creation because it must register with the Secretary of State; it should have governing documents; and it must also distribute stock to the shareholders.

Owners

An SP is owned by its sole proprietor; a GP is owned by its partners; an LP is owned by its general partner(s) and limited partner(s); an LLC is owned by its member(s); and a Corp. is owned by its shareholder(s).

Number of Owners

An SP is limited to one owner. A GP and LP must have at least two partners. An LLC and Corp. must have at least one owner but thereafter can have an unlimited number of owners. However, if a Corporation is taxed as an S-Corporation, the Corporation may not have more than 75 owners and only one class of stock.

Personal Liability of Owners

The owners of an SP and GP are personally liable for the actions of the entities. Personal liability means that the owners' personal assets may be used to pay any obligation, debt, or judgment of the partnership. The owners of an LLC and Corporation are not personally liable for the actions of the entities and their personal assets are not at risk. The general partner(s) of an LP is(are) personally liable for the LP while the limited partner(s) is(are) not.

Taxation

Taxation of business entities is a very important and complicated matter when comparing entities. Generally, the profits or losses from an SP, GP, and LP flow through to the owners. A Corporation taxed as a C-Corporation will be taxed at the entity level (corporate tax), and the shareholders will be taxed on their dividends. A Corporation taxed as a S-Corporation allows profits and losses to flow through to the shareholders in a similar manner as a partnership. An LLC can elect to be taxed as an SP (if only one member), a partnership (if at least two members), a C-Corporation, or an S-Corporation. The taxation election is one reason the LLC has become the entity of choice for many business owners. If no election is made, a single-member LLC is taxed as an SP and a multi-member LLC is taxed as a partnership.

Applicable Tax Rates

Owners of an SP, GP, LP, or S-Corporation will pay taxes on any profits at their personal income tax rate. A C-Corporation will pay corporate taxes on any profits, and the shareholders will pay either 5 percent or 15 percent taxes on dividends based on their income level. The applicable tax rates for LLC members depends on which tax structure is elected for the LLC.

Tax Treatment of Liquidation

Generally, an SP, GP, LP, and LLC taxed as a partnership will have no tax on the liquidation of assets. A Corporation will treat a liquidation as a sale and cause taxes to be paid at both the corporate and shareholder level.

Management

Management varies widely among the different types of entities and the entities themselves. However, generally, an SP is managed by the sole proprietor; a GP is managed by all of its partners; an LP is managed by its general partner(s); an LLC is managed by its members or managing member(s);

and a Corporation is managed by a board of directors elected by its shareholders. There is a great deal of variation to the previous general statements, particularly for an LLC, which has the ability to structure itself in nearly any manner.

Raising Capital

Other than a Corporation, the entities will typically raise capital by additional owner contributions. A Corporation will typically sell stock to raise capital. The other entities may sell ownership interest to raise capital but rarely do so.

Transfer of Ownership

An SP may transfer ownership freely as he/she is the only owner. A GP, LP, LLC, and Corporation will often have restrictions on transfer of ownership. Typically, the company itself and the other owners have a right to buy any ownership interest before it is transferred to a non-owner. Furthermore, many farm and family businesses make it very difficult if not impossible to transfer any interest outside the family. The restriction on transfer of ownership is either controlled by the company's governing document or a separately executed document often called a buy-sell agreement or a stock purchase agreement.

Dissolution and Liquidation Costs

Most of the costs of dissolution and liquidation are the taxes incurred due to the liquidation. Therefore, the SP, GP, LP, and LLC taxed as a partnership will tend to have lower dissolution and liquidation costs. The LP and LLC must file a notice of dissolution with the Secretary of State for a small fee. A Corporation will have the highest costs as the liquidation will create tax liability at the corporate and shareholder level. The Corporation will also need to file a dissolution notice with the state.

Acknowledgements

This fact sheet was developed as a result of a grant received by Ohio State University Extension from the North Central Risk Management Education Center, 2006.



BUSINESS ENTITY COMPARISON CHART					
	Sole Proprietorship (SP)	General Partnership (GP)	Limited Partnership (LP)	Limited Liability Company (LLC)	Corporation (Corp.)
Definition	One person owns all the assets, owes all the liabilities, and operates in his or her personal capacity.	A voluntary association of two or more persons who jointly own and carry on a business for profit.	A partnership with one or more general partners and one or more limited partners	Statutorily authorized company that is characterized by limited liability and management by members or managers.	Having lawful authority to act as a single person distinct from the shareholders who own it.
Formation	No formal requirements.	No formal requirements.	Filing with the state.	Filing with the state.	Filing with the state.
Governing Documents	None	Partnership agreement.	Partnership agreement.	Articles of organization and operating agreement.	Articles of incorporation and bylaws.
Cost of Creation	None	None or Low	Medium	Medium to High	High
Owners	Sole proprietor	General partners	General/ Limited partners	Members	Shareholders
Number of Owners	One	Unlimited	Unlimited	Unlimited	Unlimited, except 75 shareholders for S-Corp.
Personal liabilities of owners	Unlimited liability for the obligations of the company.	Unlimited liability for partners for obligations of the company.	Unlimited liability for general partner(s); generally no liability for limited partners.	Generally no liability for members for obligations of company.	Generally no liability for shareholders for obligations of company.
Taxation	Pass-through	Pass-through	Pass-through	Typically pass-through but may elect taxation as a corporation.	Entity taxation unless electing subchapter S.
Applicable Tax Rates	Individual tax rates.	Tax rate of partner.	Tax rate of partner.	Tax rate of partner if taxed as partnership; otherwise corporation tax rates.	Corporate tax rates for C-Corporation; tax rates of shareholders for S-Corporation.
Tax treatment of liquidation	No tax.	Generally no tax.	Generally no tax.	Generally no tax if taxed as partnership; generally will be corporate and shareholder level taxes if taxed as corporation.	Generally will be corporate and shareholder level taxes.

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 an equal voice.	General partners manage; limited partners have limited management authority.	Either member-manager or manager-managed (controlled by operating agreement).	Board of directors elected by shareholders.
Raising Capital	Proprietor's own funds.	Contributions from partners or adding partners.	Contributions from partners or adding partners.	Contributions, add members, or sell interest; controlled by operating agreement.	Sell stock.
Transfer of ownership	Freely transferable.	May be limitations.	May be limitations.	May be limitations; controlled by operating agreement.	May be limitations; controlled by bylaws or stock purchase agreement.
Dissolution and liquidation costs	Low	Medium	Medium	Medium, if taxed as partnership, and high, if taxed as corporation.	High

EMPOWERMENT THROUGH EDUCATION

Visit Ohio State University Extension's web site "Ohioline" at: <http://ohioline.osu.edu>

Ohio State University Extension embraces human diversity and is committed to ensuring that all research and related educational programs are available to clientele on a nondiscriminatory basis without regard to race, color, religion, sex, age, national origin, sexual orientation, gender identity or expression, disability, or veteran status. This statement is in accordance with United States Civil Rights Laws and the USDA.

Keith L. Smith, Ph.D., Associate Vice President for Agricultural Administration and Director, Ohio State University Extension

TDD No. 800-589-8292 (Ohio only) or 614-292-1868

September 2007—3613